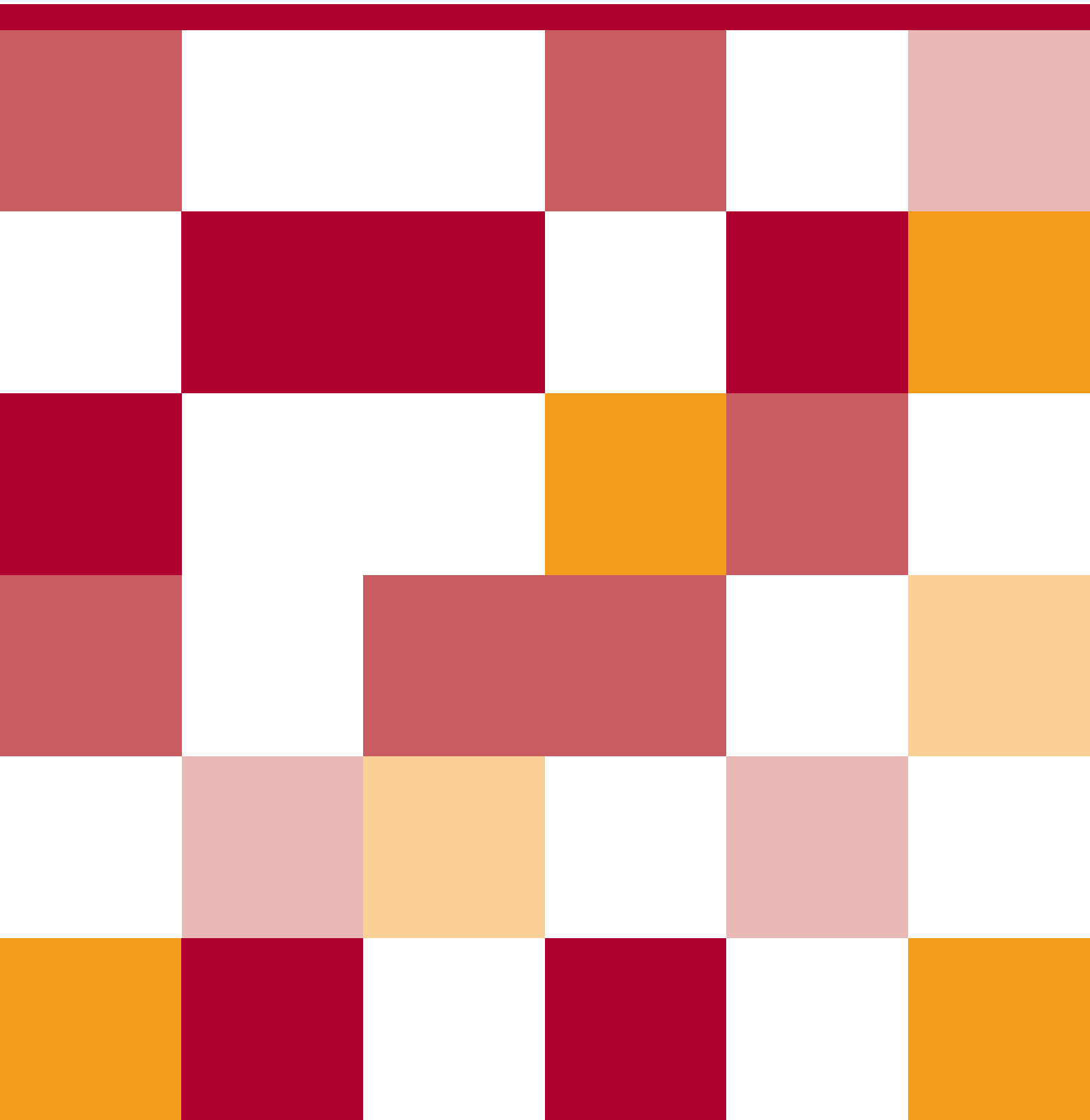




# SOCIAL INVESTMENT PILOTS

Action research final report



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# Foreword

**Kevin Brennan,  
Minister for the Third Sector**



In today's uncertain financial and environmental climate, where business responsibility is a real issue, social enterprise is now more relevant than ever. Social enterprises grow around the idea that social justice, economic growth and environmental sustainability can work together in mutual benefit.

With a business model that values tangible and sustainable relationships, and governance structures that help safeguard their mission and independence, social enterprises seek more than just short-term financial rewards. A country that values enterprise, fairness and responsibility is one in which social enterprises will thrive.

So I want to help social enterprises to thrive. Helping them to attract the right kind of investment is crucial to that. The Government is helping channel investment into social enterprises through, for example, the Futurebuilders Fund, through our £10 million Risk Capital Fund, and through the Department for Health's Social Enterprise Investment Fund.

We are also helping businesses to understand the finance options available to them through our work with the Capacitybuilders programme, through financial awareness training for social enterprises and through business support. But we also need to support the framework in which investors can meet investees.

With this in mind, in 2007 the Government financed action research into the social investment market, working with partners from Community Innovation UK, Charity Bank and Investing for Good. The benefits of this work have been threefold – in the lessons contained in this document, in the value of the new investment brought into the sector, and in the ongoing legacy of these pilots. This document summarises the findings of the projects and is being made widely available to inform the social enterprise and broader finance sectors.

What have we learned? The overriding message is positive. First, that people are willing to consider the social and environmental – as well as financial – implications of their investments. Second, that some social enterprises are aiming to grow and develop with the help of equity or equity-like investment. Of course, such investment is not necessarily appropriate for all third sector organisations, in what is a hugely diverse sector.

But there are also problems in the market. Social enterprises want investment but are not always investment ready. Socially minded investors do exist, but the products and channels are not always available to bring them to market. We need to help build a marketplace where investors and investees can come together, and to make available greater understanding of investment products which capture social as well as financial returns.

The Government is determined to help address these issues. I am excited about the potential for a Social Investment Wholesaler, which reflects our increasing recognition of a gap in the market. This vision would place importance on the provision of professional and targeted capacity building and business support, as well as financial support.

The Office of the Third Sector will also explore the potential for showcasing emerging examples of innovative forms of investment channelled into third sector organisations, such as so-called patient capital or quasi-equity. We will also aim to develop a more strategic approach to supporting demand for finance in the third sector, building on the available evidence.

I believe this could be a defining time for social enterprise and social investment. I am confident these pilots will help us make further progress towards a thriving third sector, delivering against the triple bottom line of economic growth, social cohesion and sustainable development.

A handwritten signature in black ink that reads "Kevin Brennan". The signature is written in a cursive, flowing style.

**Kevin Brennan, Minister for the Third Sector**

## Executive summary

In 2007, the Office of the Third Sector commissioned two projects to investigate ways to promote private investment in social enterprises. The objectives were to:

- increase private sector finance in social enterprises;
- deepen our understanding of how to increase the range of finance available for social enterprises; and
- successfully broaden the research base of the sector.

Community Innovation UK and Charity Bank led these pilot programmes, together worth almost £200,000.

Community Innovation UK led the 'Equity Plus' pilot, which consisted of two principal elements. First, the creation of a Social Enterprise Angel Network to encourage greater use of equity finance by social enterprises and greater investment into the sector by private investors. The project worked with investors to help them engage with social enterprises and understand their own unique mix of blended value. Second, investment readiness support helped social enterprises prepare for a successful investment. The matching process principally consisted of ensuring a good fit between the investors and investees.

Outcomes of the project include provision of education and advice to over 35 social enterprises, and approximately £800,000 of new private investment into the sector, with other deals in development. Future outcomes will include specialist consultancy on investment readiness, further development of the Social Enterprise Angel Network, and the potential for a complementary fund.

The Charity Bank action research consisted of three elements: first, research to develop an understanding of how to encourage new investors into the social investment market; second, the development of a scalable, technical infrastructure and point

of intermediation between social investors and enterprises seeking finance; and third, a pipeline of new product ideas to entice new deposits and customers.

On the supply side, Charity Bank reviewed its existing depositors, institutional investors, asset managers and financial intermediaries to increase awareness of the requirements for new types of capital-raising products. On the demand side, research was carried out among social enterprises planning to raise capital.

As a result, three infrastructure and product development projects are under way and are expected to introduce new investment into the social enterprise sector. These are online retail channels, the creation of a branch network, and a social investment fund.

Some consistent lessons emerged from the two projects:

- First, social enterprises may not always understand what it means to be 'investment ready'.
- Second, there is sufficient evidence to demonstrate that investors can be willing to pursue socially adjusted financial (or blended) return.
- Third, the marketplace for such investments is imperfect and there can be significant transaction costs and co-ordination problems in bringing investors to market.
- Finally, appropriate investment products that build in social returns are not yet widely available or understood.

The original aims of the action research pilots have been achieved, and this research should be made widely available to inform future development of the market.

## Background

In 2007, the Office of the Third Sector commissioned two projects to investigate ways to promote private investment in social enterprises.

The projects were set up to assess the scale of demand for such investment among social enterprises, and find investors who would be willing to accept a blended financial and social return on their investment. They also aimed to establish whether the lack of a network, or other infrastructure that can bring together investors and enterprises, is the major barrier to growth in social investment. The objectives were to:

- increase private sector finance in social enterprises;
- deepen our understanding of how to increase the range of finance available for social enterprises; and
- successfully broaden the research base of the sector.

Charity Bank and Community Innovation UK led these pilot programmes, together worth almost £200,000.

**Charity Bank** is the UK's only regulated bank that is also a registered general charity. It finances charities and other civil society organisations that address society's needs, with the support of depositors and investors who want to encourage a more responsible and transparent use of money. Charity Bank is not a full service bank in that it does not serve the day-to-day banking needs of the general charity sector, but is more like a development bank, financing projects and organisations that are considered to be viable but that are not always commercially bankable, or where the organisation has been offered terms that are not appropriate to its situation.

Charity Bank has committed over £70 million to charities and other socially driven organisations since its launch in 2002 and has unlocked £160 million in additional funding for its borrowers as a result of Charity Bank loans.

It agreed £15,373,000 in loans in 2007 and had £9,855,241 worth of loans 'in the pipeline' (as of May 2008). The average loan size in 2007 was £159,000.

The programme was undertaken jointly with **Investing for Good**, a Community Interest Company founded in 2004 by a team of professionals from the financial services sector. It is the first social enterprise and Community Interest Company to be regulated by the Financial Services Authority (FSA). Investing for Good's mission is to offer independent investment advice and investment management services to advisers wishing to develop a social and environmental offering for their clients. It has a multi-skilled management team with many years' experience in the financial services sector and the social sector and has developed a strong brand presence in the financial services market for expertise in social investments. Investing for Good has created the only independent research and ratings capability for social investments that has been used to build working funds and portfolios. It has advised on bespoke social impact portfolios of £15 million since it became FSA regulated in May 2007.

**Community Innovation UK** is a social enterprise consultancy organisation that provides fundraising, business development, strategy and financial management services and training to a wide range of organisations, especially social enterprises and social businesses. It aims to assist organisations in developing business plans, tendering for contracts, managing their finances and achieving significant organisational growth.

One project partner was **Resonance**, a social finance intermediary that matches values-led investment with growing social enterprises. To date, Resonance has raised investments approaching £2 million in total from a network of over 40 investors. Successful deals have included community share issues and direct property acquisitions through to international funds. Resonance helps social enterprises become investment ready and access values-led risk capital, and provides post-investment project management.

The second partner was **Celarben Ventures**, an incorporated chartered accountancy practice that works with small and medium-sized enterprises (both commercial companies and third sector organisations). Celarben Ventures has particular expertise in working with organisations that are experiencing a period of significant change or development. Celarben Ventures has been involved in a wide variety of business strategy projects and corporate finance transactions, including raising finance (both private equity and loan capital), mergers and acquisitions and sale mandates, and transactions with deal values ranging from £250,000 to over £100 million.

# Equity Plus

## The proposal

The Equity Plus model consists of two principal elements. First, the creation of the Social Enterprise Angel Network to encourage greater use of equity finance by social enterprises and greater investment into the social enterprise sector by private investors.

The Social Enterprise Angel Network worked on the basis of matching prospective private investors with social enterprise organisations seeking investment. The matching work is based on establishing both a supply funnel and a demand funnel and comprises the following elements:

- identifying social enterprise investment opportunities compatible with the investment preferences of angel investors;
- undertaking initial screening of the social enterprises (business model, target market and strength of management);
- working with new investors or investors new to the social enterprise sector to help them understand their personal investment preferences and the type of financial/social/environmental return they are seeking;
- identifying specific angel investors that may be interested in prospective social enterprise investees; and
- developing approaches to corporate finance work required to put deals together.

Second, investment readiness was provided to social enterprises in advance of investment. This entailed working with social enterprises on an individual basis to help them:

- clarify their business model and current financial position;
- identify potential market opportunities to support their growth;
- identify the business's competitive edge or unique selling point;
- put in place an accurate set of financial statements (profit and loss, cashflow forecasts and balance sheet), enabling them to present their finances to potential investors in a clear and effective way;
- identify the most appropriate types of finance and the right mix of finance to meet their investment needs;
- identify specific equity-based investment needs and the opportunities they could offer to social business angels;
- identify any potential barriers posed by the legal structure and suggest solutions; and
- develop a robust business plan and present the expertise and track record of the founders and management team.

## Case Study 1 – Mustard Seed

Mustard Seed is a small charity working with people with learning disabilities to provide them with supported living in Cornwall. Following a scathing report by the Commission for Social Care Inspection and the Healthcare Commission into services at the primary care trust, the trust's supported living services were decommissioned.

Mustard Seed wanted to fill this gap in supported living and partnered with Prospects, a national domiciliary care provider. To develop its work, Mustard Seed needed to acquire a property that would enable the charity to provide life-long holistic support to the community. The property would also provide Mustard Seed with an additional income stream.

Mustard Seed needed £160,000 in order to secure a big enough site with development potential. Given the urgency of the need and the size of the investment required, neither debt financing nor traditional fundraising were possible.

Resonance, one of the partners in Equity Plus, worked with Mustard Seed and helped it set up a separate industrial and provident society to enable a share issue that would raise the funds, to manage the property and to lease it to Mustard Seed. The share issue was set at a minimum investment of £1,000, with a 3.5% return.

One investor said: "Not all investments are highly profitable or secure, but I consider 3.5% a fair return as I would rather support vulnerable adults enjoy the dignity of living as independently as possible than have the extra £1 per week interest that I'd get if my £3k was in a savings account."

Two investments of £60,000 and £50,000 were made by Resonance's investors. The rest of the shares were bought by individuals making investments of between £1,000 and £20,000. Resonance also introduced a business angel to provide a £220,000 three-month bridging loan to secure the site while a mortgage from Triodos Bank and other funds were drawn down. With the shares successfully sold, Mustard Seed was able to refurbish the property and make it available to local families in desperate need of it.

## Implementation

One-to-one meetings were held with over 35 social enterprises over the course of the project, with around a dozen workshops in London, Worcester, Leeds, Bristol, Portsmouth and Liverpool held for prospective investees. Investment readiness support, working with social enterprises on an individual basis, helped them prepare for a successful investment.

The project also worked with investors to help them engage with social enterprises and understand their own unique mix of blended value. Investors were principally high net worth individuals, who in many cases were also experienced entrepreneurs with a broad spectrum of investment interests and from a wide range of industries. Typical Equity Plus investors:

- were high net worth individuals and sophisticated investors;
- sought direct purchase of shares in one specific social enterprise;

- were interested in start-up, early stage and development stage;
- displayed a high appetite for risk;
- were interested in holding the investment for one to three years;
- sought financial return as a combination of fees, running yield and capital gains; and
- were keen to invest between £25,000 and £100,000 (start-up), £100,000 and £250,000 (early growth) or £200,000 and £600,000 (development).

The matching process principally consisted of ensuring a good fit between the investors' and investees' financial resources, requirements and values, and then introducing investors to investees on a one-to-one basis.

## Case Study 2 – Cornwall Neighbourhood for Change (CN4C)

CN4C is a charity and social enterprise that was formed from a partnership of residents and social landlords to improve the quality of life for disadvantaged neighbourhoods in Cornwall. With a dedicated board of trustees and a staff of 50, it had been looking for permanent office premises for three years.

Resonance, one of the partners in Equity Plus, found a suitable property and was able to negotiate with the private landowner a favourable sale price on the land based on the social benefits that the organisation would be able to deliver. CN4C needed 12 months to raise funds for part of the site and needed a partner to secure it from the vendor and offer them a 12-month option.

CN4C initially presented a proposition to a Community Development Finance Institution (CDFI). Unfortunately, given the unusual 'equity' proposition, the CDFI was not able to help CN4C and another finance solution was needed.

Resonance introduced an investor who used his charitable trust to invest the £625,000 needed to purchase the property and pay the professional fees involved. The trust offered CN4C a 12-month option to purchase the site for its offices and proposed to build 10 residential units – half for private sale and half as affordable homes.

Following the investment and the purchase of the site, a housing association teamed up with CN4C, realising now that the organisation was serious about the project. The housing association offered to double the length of time on the option, proposing to develop 100% affordable housing, and suggested a partnership with CN4C in the management of the whole site. They agreed an uplifted price that was still less than market value. The investor therefore achieved an early exit, doubling the expected social impacts and receiving a better-than-expected internal rate of return.

## Outcomes

Outcomes generated through the pilot so far include:

- **education** of a wide range of social enterprises about the benefits of equity investment;
- provision of tailored investment and finance-raising **advice to over 35 social enterprises** and in-depth finance-raising work with several social enterprises;
- two social enterprises with investors, which resulted in **approximately £800,000 of new private investment** into the social enterprise sector;
- seven **other initial investment deals in development:**
  - o h2oPE;
  - o Career Energy;
  - o Motivation;
  - o Concentrate;
  - o Walkit.com;

- o GreenKnickers; and
- o TSS;

- Concentrate has secured **investment outside the Equity Plus project** on Dragons' Den. The others remain potential investees and Equity Plus continues to work with angel investors to secure investment.

Legacy outcomes to be delivered in the future include the following:

- Specialist investment readiness consultancy. Through this project, Equity Plus has identified the real need for social entrepreneurs in the sector to become more financially aware and to improve their financial planning and forecasting. Furthermore, Equity Plus sees a need for additional advice in structuring investments in social enterprises, due to a shortage of corporate finance professionals in the sector. Equity Plus believes it is ideally suited to help fill these gaps and will **develop its role into a specialist service** accordingly.

- Continuation and further development of the Social Enterprise Angel Network. Through delivering the action research project, the Equity Plus partners developed a strong commitment to continuing to develop the Social Enterprise Angel Network following the end of the action research project. The partners have **established Equity Plus Ltd** as a new legal entity and as a joint venture between the three organisations. They expect social investors that are part of SEAN to **invest between £750,000 and £1 million in the social enterprise sector** over the coming year.
- Future **development of a complementary fund**. Equity Plus believes that considerable benefits could be leveraged through managing a complementary fund. This could take the form of co-investing alongside angels but could also provide for a succession or exit when angels have absorbed the early-stage risk and are looking to recycle their money.

## Lessons

On the **demand** side, the research resulted in the following findings among social enterprises:

- Introducing equity to social enterprises takes time. Social enterprises are only now getting used to thinking about equity-based financial products, in part due to the rise in general public awareness through television programmes such as Dragons' Den. We encountered in some cases very limited understanding of equity investment.
- The patient and risk-sharing nature of equity investment, although appealing to social enterprises, is balanced by the difficulty of being prepared to share control and/or ownership.
- Social enterprises tended to not be investment ready. Many of the enterprise managers themselves have relatively low levels of financial literacy and therefore basic financial skills such as creating an accurate set of financial statements have often been lacking. Similarly, some basic financial language has had to be explained, such as internal rates of return (IRR) and how this differs from consumer terms such as annual percentage rate (APR).
- There is a high level of innovation coming through in the UK social enterprise sector, but the sector is still in the early stages of growth. Of the 60 social enterprises encountered, 35 or so had some genuine potential for private investment, and six of these were investment ready by spring 2008.
- The best prepared investees were ones coming through recognised incubator/support networks such as the Hub or UnLtd.
- Among social enterprises that perceived themselves to be right for equity investment, many in reality did not have sufficient ambition or plans to scale up their model and were therefore unlikely to generate the growth-orientated returns needed to justify an equity-based investment.
- Most social enterprises are unwilling to accept that they deliver anything less than 10 out of 10 in terms of social/environmental value. In practice, this creates challenges in helping them understand that potential investors may find alternative models that create higher levels of social impact and are therefore more attractive investment propositions.
- The Community Interest Company (CIC) structure may present particular challenges in terms of understanding the incentives for early-stage investments. Returns over different rounds of funding to investors in a CIC limited by shares may be affected by the dividend cap and asset lock to different degrees.

On the **supply side**, the research found that the following points applied to social investors:

- High net worth individuals are happy to look at any size of deal value from £25,000 upwards, although the minimum deal value is likely to be around £100,000 and they would usually only invest £25,000 as part of a syndicate.
- Crucially, investors want to be recognised financially for taking the risk on a start-up or very early investment. Despite their commitment to social impacts, investors are still keen to benefit financially where their early-stage, higher-risk investment can enable an enterprise to generate strong financial returns.
- An increasing number of investors find the concept of blended value a useful one in self-evaluating their own investment priorities.
- A poor match of values leads to the devaluation of an investment opportunity and wastes the investor's and entrepreneur's time. Therefore proper analysis and understanding of the social values created in a venture and those held by a private investor are critical to a successful deal.
- One of the main barriers for investors is the time taken to consider an investment decision. While it can often be a quick and easy decision to make a donation, investment requires due diligence and ongoing monitoring which takes considerably more time for investors.
- The wider economic situation can have an impact on investors' willingness to invest.
- Many investors were keen to explore ways in which they could play a more participative role in the enterprise they were investing in rather than merely investing money. In reality, many of the investors were unable to commit time alongside financial resources.
- It takes time to cultivate relationships with individual investors.
- Investors were often willing to take a modest financial return where there was a strong correlation between the social/environmental impact being delivered by the investee organisation and their own values and priorities.
- Where a potential investee was delivering social impact that was not so close to their personal priorities, several investors were still willing to consider them as an investment opportunity but wanted to see a financial return that was closer to more commercial levels.

In terms of **the market working effectively**, the research found the following:

- Investment readiness work was critical to the success of the overall Equity Plus model; without this work potential investees would have struggled to persuade investors that they had the necessary financial skills.
- There is some evidence that support to social enterprises provided by various intermediaries can be patchy. Intermediaries do not have the combination of: i) sufficient expertise in corporate finance; ii) a strong understanding of social enterprise; and iii) the ability to provide the required service for a cost commensurate with the size and value of the deals to structure equity-based deals. The transaction costs are potentially prohibitive and can prevent deals.
- Other investment funds took longer to arrange than the angel investors and the social enterprises and/or impose onerous conditions on investment offers.
- Venture philanthropists often do deals with social enterprises that have the potential to make

the largest commercial returns, and that could instead be funded by social venture capital. Social enterprises choose to do deals with venture philanthropists because the cost of capital is lower or non-existent, and the philanthropists can absorb the transaction costs. This can distort the marketplace. If philanthropy were employed only where social venture capital were not available, this would create more sustainable market conditions for long-term solutions to financing social enterprises.

- Another challenge for UK social enterprises is that investors may make direct comparisons between UK-based social impact opportunities and those overseas. Micro-finance and clean technology investment opportunities may offer higher financial and social returns, which makes it relatively difficult for domestic social enterprises to attract investment.
- There appears to be an equity gap between £80,000 and £250,000 post-proof of concept stage, where businesses are trading but with subsidies (either grant or in-kind support) and need to grow quickly to reach sustainability.
- Community share issues can be a useful way of leveraging locally based small-scale investors alongside larger investments made by high net worth individuals.
- Risk profiling remains a very difficult and underdeveloped concept for social enterprises, with much effort instead being directed towards measuring social return on investment (SROI).

# Charity Bank and Investing for Good

## The proposal

The model consisted of the development of three elements:

- **research** to develop a detailed understanding of the product or service that will encourage new and prospective customers, the capacity to translate this to a service, the current obstacles that exist which prevent increased investment, and the feasibility of translating these into a pipeline of new product ideas and offerings to entice new and different investors into the social investment market;
- the development of a scaleable, technical **infrastructure** that provides a service cost-effectively in one centre and can be easily extended to other centres. Leeds in Yorkshire is the first regional branch to offer an advisory/sales centre, with potential for the creation of a branch network by Charity Bank to showcase a physical presence and point of intermediation between social investors and enterprises seeking finance; and
- as a result of feedback from retail investors, institutional asset managers and professional intermediaries, a pipeline of new **product ideas** to entice new deposits and customers. Charity Bank is dedicated to popularising financial products and services that provide investors with a blended social and financial return. The development of these hybrid capital structures aims to attract those seeking financial and social returns, reflecting the preferences of investors in terms of risk, return and impact, as well as improving the terms and increasing the amount of available capital to social enterprises.

## Implementation

The project has been actively researching institutions on both the demand and supply side since November 2006. The programme began in mid-February 2007 and the first regional interviews were held in Yorkshire and London between March and September 2007. Visits were made in both London and Yorkshire (principally in York, Leeds and Rotherham) to investors and their advisers to test the appetite for investment and whether regional investment decisions are made locally or in London. Additionally, interviews have been carried out by mainstream, head office financial institutions in London to provide additional feedback on a national basis. Charity Bank also researched its investor base for those in Yorkshire and the Humber separately.

On the **supply** side, Charity Bank reviewed its existing depositors, institutional investors/asset managers and financial intermediaries to increase understanding of the requirements for new types of capital-raising products.

- **Retail investors** – Charity Bank surveyed its existing 1,400+ depositor base as well as its investors to assess the potential to cross-sell a new range of investment products – for example, loan notes, self-select portfolios or sector funds.
- **Institutional investors** – Investing for Good interviewed both local and national institutional funds and asset managers to assess their willingness to explore 'off-balance sheet' transactions, such as loan sales, loan underwritings and third-party agreements. Investors included ABN AMRO, CCLA, Royal Bank of Scotland, Citigroup, Hermes, Planning for Life, Rollits, Fisher Family Office, Yorkshire Investment Group, RBS Coutts Private Banking, the Wrigleys Company, Kleinwort Benson Private Bank, JP Morgan, South Yorkshire Investment Fund, Brewin Dolphin, and the Friends Provident Foundation.

- **Professional intermediaries** – Investing for Good interviewed both local and national professional intermediaries to ascertain their appetite for promoting these types of products to their client base.

On the **demand** side, research has been carried out among social enterprises planning to raise capital. Charity Bank surveyed its existing borrowers to explore the suitability of more flexible loan products for them. Charity Bank has reviewed loan enquiries received from Yorkshire and the Humber since January 2006 and has assessed the levels of finance those enquirers could have sustained. It has also worked with CRN UK (Community Recycling Network) and other umbrella organisations to identify up to six test cases for private investment. Charity Bank has also developed its Bridging Two Worlds programme to explore the appetite for sharia-based social enterprise investment.

## Outcomes

As a result of the research undertaken by both Charity Bank and Investing for Good, the following three infrastructure and product development projects are under way and are expected to introduce new investment into the social enterprise sector.

### 1. Online retail channels

Charity Bank is in discussions with Zopa, eBay and Kiva to create a social investment marketplace that will provide the disintermediation of small-scale social investing and enable every investor to become a social investor.

Organisations such as Zopa could provide online marketplaces for social lending where individuals can borrow small sums of money and lenders can choose the credit rating, term and interest rate at which they wish to lend. Loan capital is diversified across the pool

of appropriate lenders to diversify their risk. Zopa, for example, earns by charging borrowers a 0.5% transaction fee and lenders a 0.5% annual servicing fee.

The product could focus on loans of up to £35,000 for periods from six months to five years, with the potential for Charity Bank to act as co-lender to provide extra confidence, if necessary. Charity Bank would screen, underwrite and monitor each charity or social enterprise listed and the interest rate ceiling would be set by Charity Bank as part of the due diligence process.

Zopa would provide the site, hosting and management of the system as well as its current due diligence on lenders. A social Zopa would develop a unique partnership, offering access to finance for low-value transactions and extend social investment to all investors. It would enable lenders to support enterprising community organisations in their own communities without giving money away.

It is expected that, should this develop, £3 million to £5 million could be raised for social enterprises in the first three years of operation.

### 2. Yorkshire Deposit Bond and branch network

Charity Bank has started to create a branch network to showcase and promote its offerings and provide a physical presence for both borrowers and investors. This branch network will provide front-office advisory and information services to the investors and borrowers listed above. Leeds has been set up as the first Charity Bank regional branch with an advisory/sales centre.

Charity Bank launched the Yorkshire Deposit Bond on 9 November 2007 as part of its Charity Bank in the North programme. The Yorkshire Deposit Bond is a fixed-term, 12-month standard deposit account with a minimum deposit of £1,000. The Bond will pay:

- 2.00% AER/gross interest on amounts up to £9,999;
- 3.00% AER/gross on amounts of £10,000 and over; and
- 4.00% AER/gross on deposits of £50,000 and over.

It is expected that the Yorkshire Deposit Bond will raise a total of £10 million for social enterprises in the first three years of operation.

Charity Bank has also begun the development of an online facility to satisfy the client experience as well as to meet the business process and governance requirements of the Bank. This provides information on Charity Bank offerings and pools of resources, including terms and funding priorities. Each pool will be categorised to produce a list that is relevant to an applicant. The first version of this online forum has been developed and is currently being refined.

### 3. Social investment fund

In December 2007, Investing for Good began the process to extend its FSA authorisations to include an investment management capability. This could offer mainstream financial intermediaries and advisers the opportunity to develop own-brand social investment funds and outsource the management of those funds to Investing for Good.

Alternatively, Investing for Good is looking at developing a social investment fund targeted at institutional or nominee-style investments. This fund would focus on social enterprises and social investments, both in terms of debt and equity financing, and would deliver a return of between 4% and 8% a year.

Interest has been shown by clients in becoming cornerstone investors, since it is a way for mainstream operations to start engaging easily and cost-effectively

in a new and unknown market. The expectation is that between £5 million and £30 million of new investment will flow into the sector.

### Other outcomes

In addition, and as a direct result of the education and awareness-raising opportunities in the social enterprise market that took place through interviewing advisers in the North East for this project, Investing for Good has created a portfolio of £250,000 and is in the process of creating another of £100,000.

### Lessons

The research found that the following applied to investors:

- Social investors understand the concept of social investing, will undertake greater risks and are prepared to take less than market rates in exchange for a social return. This is in stark contrast to the regulated financial institutions that advise on, control and manage assets on behalf of private investors, institutional funds and charities.
- It was found that mainstream investors:
  - o showed limited understanding of the difference between social enterprises and social businesses and lacked consolidated, useful and easy-to-use information on the sector;
  - o perceived social investments to be risky, and suitable only for a limited number of qualified investors;
  - o were often less interested in strategies to mitigate the risk of social investing, viewing the social return as the primary driver; and
  - o would generally segment their clients by wealth rather than by type or attitude.

- However, looking forward, investors:
  - o acknowledged the opportunity to add diversification to traditional portfolio management;
  - o were keen to support the development of a social investment fund, which would be the means for advisers to distribute this type of service to their clients;
  - o believed it essential that advice, products and services are delivered through an FSA-regulated entity;
  - o showed growing interest among discretionary asset managers with charitable foundation portfolios; and
  - o were very interested in attending, hosting or organising seminars and workshops for clients.

Yet existing products are either quasi-philanthropic/capacity building or focus on high-return/high-risk 'ethical' or 'green' venture capital. There are no products or structures that are designed from a mainstream investor's perspective and that bring generic capital into the sector.

Consequently, the action research concluded that increasing the amount of risk capital invested in this sector may require products structured along the following lines:

- 'vanilla'-style products delivered through a regulated entity;
- designed and structured so that they are easily approved by product panels;
- able to deal with all post-trade processing issues and idiosyncrasies of the social investment sector;
- available through existing reporting platforms; and
- easy to sell, with excellent marketing material.

To attract institutional asset managers, the minimum size transaction would need to be in the region of £50 million, which may be premature for this sector at the moment.

Blended-value products can operate quite differently from conventional securities, and this has implications for the way in which these products are packaged, structured, sold and administered. For example:

- financial markets seek to depersonalise investor needs and offer the same class of investors the same return, whereas the social capital market allows each investor the return that matches their social objectives;
- in traditional financial markets, investors are seeking exclusively to maximise their financial return, whereas in the social capital market social impact and control of losses may be paramount;
- liquidity, which is a key concern in the conventional investment market, appears to be a less pronounced need in the social marketplace; and
- traditional financial institutions, ever watchful for better patterns of risk and reward, are beginning to incorporate social and environmental issues as a third dimension. Products that combine these three elements will improve deal flow into the sector.

Post-trade processing and liquidity are also issues. Current social investment product offerings are disparate and non-standard. This is a barrier to investors, whereas products that fit existing reporting and administrative platforms or are listed on recognised exchanges are far more likely to succeed in attracting mainstream finance.

# Conclusions

## The proposals

The two action research projects took very different forms.

The first project, delivered by Equity Plus, sought individual investors and aimed to match them with potential investees: in other words, identifying supply, identifying demand and creating a marketplace. This also necessitated a substantial amount of groundwork before deals could be made – investment readiness. Potential deals required development and some heavy lifting to get them to the point where the relationship could be realised. This took practical effort, working with investees and investors on the ground.

The second project, delivered by Charity Bank and Investing for Good, took a different approach. First, it acknowledged that what it takes to attract a supply of investment into the sector was, to some extent, unknown – and so set out to establish this. Second, it involved the subsequent creation of standard products that could enable scalability and keep transaction costs down. Third, it entailed the creation of a more systematic platform for matching demand and supply – rather than the more case-by-case approach above.

This distinction between the two projects reflects, in part, the difference between the nature of the investors. The first project sought to attract a relatively low number of high net worth individual investors with considerable resources and some flexibility in their approach. The second pursued the potential for attracting a broader base of investors, although channelled through rather less flexible institutions and systems.

## Implementation

The Equity Plus project entailed a considerable amount of work on the ground, meeting potential investors and investees, running workshops and considerable ‘hand holding’. While Charity Bank and Investing for

Good also undertook research through interviews and visits, the project also provided the opportunity to revisit and review existing data and information.

## Outcomes

Many social enterprises benefited directly from the action research undertaken by Equity Plus. The £800,000 of new investment attracted into the sector is the most tangible outcome and by itself may justify the pilots. Other deals are also in the pipeline, while some social enterprises are attracting investment from other, more unexpected sources. And still more investment will follow as Equity Plus develops into a provider of specialist financial advice, an angel network with a longer lifespan than originally anticipated, and even a potential investment fund.

Through the other project, Charity Bank and Investing for Good are attracting up to £10 million investment in the Yorkshire area. This represents a considerable level of new investment in the sector. And again, more is likely to follow. Charity Bank’s discussions with Zopa about the potential for an online retail channel offers the exciting promise of a widely accessible platform for attracting social investment from previously untapped sources. Furthermore, the promise of a potential investment fund may attract even greater resources into the sector in the future.

## Lessons

Some consistent lessons emerge from the two action research projects, however different they may have been.

First, **social enterprises may not always understand what it means to be ‘investment ready’**, despite the existence and efforts of existing support networks. In particular, social enterprises may be reluctant to consider the potential, and relevance, of equity to their businesses, and may lack an understanding of how this may relate to their social

mission. This represents at the very least a significant transaction cost, if not an insurmountable barrier, which limits the potential for equity investment in many social enterprises.

Second, **investors can be interested in social return**. While it may take time and resources to align their particular preferences or expectations with appropriate investees, and while they may still pursue this in tandem with financial return, there is sufficient evidence to demonstrate that investors can be willing to pursue socially adjusted financial (or blended) return.

Third, **the marketplace for such investments is imperfect**. The transaction costs of bringing either individuals or institutional investors to market can be significant, prohibiting deal flow. Even then, demand and supply can remain misaligned, due to the complexity, asymmetry and imperfect quality of information on the financial risk of investment, and, perhaps even more challenging, the difficulty in quantifying social return.

Finally, **appropriate investment products that build in social returns are not yet widely available or understood**. New products that can be understood by investors need to be adjusted not only for risk but also for social return. There is also a need to consider how traditional appetites for liquidity and engagement with investees translate in a social enterprise environment.

## Final conclusions

In returning to the original aims of the action research pilots, the following outcomes have been achieved:

- **Increase private sector finance in social enterprises** – The pilots have delivered significant new investment already. Many millions more may follow as a direct result of this work.

- **Deepen our understanding of how to increase the range of finance available for social enterprises** – This objective has been met, with some common lessons emerging across both pilots.
- **Successfully broaden the research base of the sector** – By publishing this report, we hope to meet this objective. This should provide evidence that may reinforce the experience of practitioners in the market, or may be new to others.

Together, we believe these outcomes represent a good return on the Government's investment in the pilots. There should be further outcomes to follow.

The challenge now is how to act upon the research gathered through the work of these two pilots in order to increase private sector finance in social enterprises, to help ensure that social enterprises are able to access the finance appropriate for them, and to continue to develop an environment that enables the sector to thrive.

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