

**Report
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CAN SOCIAL FINANCE MEET SOCIAL NEED?

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Foreword

This paper is a follow-up to “Does Social Finance Understand Social Need?” in which Robbie Davison, an experienced social enterprise practitioner, started to examine the social finance market from the perspective of an entrepreneur in a community-based organisation seeking to survive and expand while tackling social need in an increasingly austere economic climate.

“Can Social Finance Meet Social Need?” is co-authored by Robbie Davison and Helen Heap. It adds the perspective of an experienced finance professional who has most recently been working on developing business models suitable for social finance funding within a charity setting.

“Can Social Finance Meet Social Need?” picks up the discussion of whether the current social finance model fits the needs of community-based social enterprises. In this paper we offer an analysis of the current marketplace and propose some ideas as to how to close the gap between the social enterprises that are looking to provide innovative solutions to meet social need and the funders who have the money to finance them.

The paper is intended to challenge, but most importantly, to stimulate discussion and debate within the social finance market. As with the first paper we are hoping to stir up a lively and important dialogue about social finance and its “partnership” with social enterprise...

... Feel free to join in!

June 2013

Can Social Finance Meet Social Need?

Executive Summary

1. The market for the provision of services to meet social need is underdeveloped but evolving quickly. As public sector spending and service provision is cut, large private sector companies are becoming increasingly involved in this market, pursuing scale economies, back office efficiencies and standardised provision in order to provide basic service levels for beneficiaries at a cost that enables providers to make a financial return. The authors of this paper argue that most currently available forms of social finance are suitable only to meet the funding needs of these types of organisation.
2. The most innovative solutions to difficult social problems are most likely to come from highly motivated social entrepreneurs running enterprises based within the communities that they serve. But this group finds it hardest to get appropriate funding, therefore these solutions often don't get off the ground and the social enterprises providing them are unable to develop into sustainable organisations. We suggest that the absence of suitable funding for this type of organisation represents a crucial gap in the market for social finance.
3. This paper makes a key distinction between funding that is intended to build a social enterprise from its earliest stages in order to achieve long-term sustainability for the organisation - **Builder Finance**; finance provided to pay for ongoing service delivery for beneficiaries prior to revenue models being established – **Grants**; and funding that supports expansion and development for organisations that have well-established revenue models – **Social (Expansion) Finance**. Each of these is important and they all do different jobs. It is hoped that by defining terms in this way entrepreneurs and funders alike can save much time and effort by identifying at the outset which type of funding is likely to be most suitable for social enterprises at their own particular stage of development.
4. We show how the processes of innovation and product development undertaken by social enterprises seeking to meet social need will often enable organisations in the earliest stages of company development to deliver substantial social value even before sustainable revenues are generated. These enterprises will not have the means to pay interest on loans, or to meet regular repayments of debt, but by finding new solutions to some of the most intractable social problems they will often deliver social impact that goes well beyond the immediate beneficiaries and communities that they serve.
5. Only if these enterprises are supported through a period in which they can develop products and services that meet social need in a financially viable way are they then able to deliver both social and financial returns and take on the kind of funding that is currently provided by the social finance market.
6. We ask are there any investors out there who are prepared to accept **only** social returns for an initial period with a high risk of capital loss, plus the prospect of sustained positive social and financial returns in the medium and long-term once the organisation achieves financial sustainability? The absence of genuine risk capital prepared to accept a period of social returns only is the key gap in the social finance market that exists today.
7. The authors welcome the establishment of Big Society Capital (BSC) and with this paper we hope to help BSC deliver on its mission to “Effectively and efficiently channel appropriate and affordable capital to the social sector”.

8. In its role as investor in social investment finance intermediaries BSC will be an important provider of capital to the sector. However, BSC's "need to balance the overall levels of financial risk it takes in pursuit of social impact with the need to generate sufficient financial returns to remain operationally viable" means that there will be substantial parts of the social sector that will not be able to access any of the capital provided from this source. We provide a picture of the market for social need in order to show where the gaps are and offer some suggestions as to how they may be addressed.
9. We urge the Boards of The Big Society Trust and Big Society Capital to think more creatively and expansively about the important role that they can perform in supporting early stage social enterprises, and charities who are developing trading capabilities, in obtaining the right sort of capital. We would also like to see formation of The Big Society Foundation as soon as possible with a view to it working alongside the philanthropic sector in order to ensure that all parts of the market for social need have the opportunity to have their funding needs met.
10. Without meaningful dialogue on what the social issues are, which are the social enterprises with the best ideas, and what are the most appropriate financial instruments that can connect investors to the entrepreneurs in a mutually beneficial way, it is unlikely that the markets for social need or social investment will ever fully develop. The BSC Group is uniquely placed to bridge the gap, create and sustain the dialogue and facilitate the development of new financial instruments that will meet the capital needs of all social enterprises, whatever their stage of development. The BSC Group has a crucial role to play as a market maker as well as investor in order to facilitate better matching between the enterprises that need capital and the investors who can provide it. We look forward to participating in that process.

Can Social Finance Meet Social Need?

Introduction

“Marx, without question, was right on the important issues. Groucho, not Karl. He said: ‘Politics is the art of looking for trouble, finding it, misdiagnosing it, and then misapplying the wrong remedies.’”¹

Replace the word politics with the words social finance and you start to capture the topic/tone of debate that is most prevalent amongst those involved in UK social enterprise. It is a debate that is already divisive and in the long term has the potential to seriously undermine the integrity of the whole social enterprise movement.

This paper is a follow-up to “Does Social Finance Understand Social Need?”² In it we look to progress the discussion into a space where solutions are apparent and social enterprise can better access the funds held within social finance.

“Does Social Finance Understand Social Need?” examined the current social finance market from the perspective of a social enterprise practitioner seeking to tackle pressing social issues within an austere economic climate. It was intended to “stir-up a lively and important dialogue about Social Finance and its ‘partnership’ with Social Enterprise...” Specifically, the debate is becoming increasingly polarized around the question of whether the current social finance model fits the needs of the community-based social enterprise marketplace.

Following the circulation of the paper, a debate largely conducted through web-based commentary indicated two things:

1. There was almost universal support for the idea that something needs to change if money is to start circulating with any meaningful purpose and land where it is required most.
2. As the commentary dug a bit deeper it also became clear that the gap between social enterprise practitioners looking for money and social finance intermediaries looking to protect their capital is as wide as ever. On the one hand, practitioners, with their sights firmly fixed on tackling social need, are vigorously chasing the money needed to service their entrepreneurial goals. Meanwhile, financial intermediaries are looking to invest their funds in the “safest bets”. This means familiar delivery models, often replicated from the public sector, that safeguard stability and/or growth but which deliver social outputs only as a by-product of lending. It was never meant to be like this.

We live in a country that is already the third most unequal developed country in the world. In it, according to Dr Simon Duffy, social care will be cut by 33% by 2015 and on current projections will be cut by 50% by 2018. This is the deepest cut to any part of the welfare state since its creation and yet it is going entirely unnoticed.³ Then take a look at the push to reduce benefits and the Government target of a reduction of £22 billion in the next 2 years, backed up by rhetoric of “shirkers and strivers”. All this in a climate where in many Northern city areas there is only 1 job for every 6 people looking for work. We have significant problems to address and now, more than any time in the past 20 years, the word poverty is prevalent in discussions about social welfare. It was never meant to be like this either.

The glamorous response is for all involved in policy and distribution to request more entrepreneurship and social innovation, as if through the energy and optimism of the words themselves, change will appear. Recently, the European Commission produced another paper titled the “Guide to Social Innovation”⁴ talking up the benefits of innovation and how it can play out to offer societal solutions. This is, of course, true but undertake a quick literature review of many other papers produced on the same topic in recent years and what can be quickly surmised is that innovation becomes little more than a philosophical think piece, espoused by those who have the time and resources to push the problem up the hill, whilst progressively in times like these the problems become that much more pernicious and harder to solve.

Social enterprise sets out to tackle problems that are hard to solve in places with the greatest need. The better able of the entrepreneurial types can articulate how, through innovation, those problems can be solved, over time, with patience and with financial support – there are lots of entrepreneurs with innovative ideas that over time could scale. However, the social welfare marketplace has changed dramatically, with the funds to treat need being removed or reshaped almost with equal measure. Those who are in the re-shaping industry choose to do little more than to tinker around the edges, leaving little scope for entrepreneurs to grow or even join in.

Some within the social finance industry say treating need is not their focus. In fact, one Big Society Capital representative rightly acknowledges that social finance is not for everyone. But without clarity and designation, those who think social finance should be about need will continue to agitate and grow angry, while those who are within the social finance fraternity will continue to ignore it, albeit with a watching brief. This solves nothing. If solutions are to be found for societies’ ills, failing models that are based on safe, quantitative coverage need to be adjusted or discarded and new approaches predicated on enterprise and driven by qualitative participatory modeling should be encouraged to emerge. Qualitative modeling requires a longer-term assessment whereby the narrative of the idea/ solution takes precedence over the pre-occupation with short-term returns and or profitability.

This paper aims to offer solutions to close the gap between those who want to innovatively treat need and those who are in need. It acknowledges that community based social enterprise will largely have to look somewhere other than social finance for its funding and that most of the current social finance incumbents should be left to invest in their true purpose, which is to be part of the re-shaping of the public sector. Too much time and energy has been wasted on skirting around the issues in the hope that almost by accident a compromise will appear to satisfy both sides. This will not happen and the sooner we face up to the facts, the sooner we will be able to achieve real change.

To paraphrase Raphael Behr, let’s not sit here grumbling about the food, when we could be writing a different menu for a new sort of restaurant. The goal for this document is to start the discussion that builds that new restaurant.

Definition of Social Need

In “Does Social Finance Understand Social Need?” a distinction was made between “need” and “impact”.

“Need, by definition, ‘requires something because it is essential or very important.’ Need focused work, requires product/service solutions - it is outcome based. Whereas impact can require nothing more than contact and/or advice – it is in general terms, output based.

The former sets out to solve problems, the latter to fix.”

Definitions of Social Finance and Social Investment

Social Finance: Looks to finance shorter-term output focused services. This money is a buyer into, or of, established models and either avoids risk altogether or buys into riskier models only when other finance is secured to absorb any potential first loss.

Social Investment: Takes a longer-term view and is outcome focused. This investment is about building enterprise solutions and is much more comfortable with risk.

I. Meeting Social Need – Briefly Explaining the Market

Many products and services designed to meet social need have traditionally been commissioned, and often provided, by the public sector and/or charities. The current difficult environment for public finances means that public expenditure is forecast to fall by around £20bn or 3% in real terms between 2010-11 and 2015-16⁵.

NCVO estimates that cumulatively, the voluntary and charity sector will stand to lose £3.3bn over the spending review period (2011-2016)⁶. That is a significant proportion of total contract income from statutory bodies at voluntary organisations which was estimated to be £10.9bn in 2009/10, an increase of 157% in 10 years. Over 80% of those contracts were delivered by organisations with an annual income of £1mn or more.⁷

While there has been a fairly widespread expectation that social enterprises will play a key role in the delivery of public services, not least by the Government itself, the reality is that income from trading with the public sector is the main source of earnings for only 18% of social enterprises. Many social enterprises are actually diversifying away from public service markets in order to survive and expand.⁸

As public sector spending and service provision is cut there is an increasing need for alternative providers to fill the gaps if social needs are to be met. It is estimated that the value of government contracts handed to the private sector has doubled in four years to £20bn, as the coalition has sought big cuts in the cost of delivering public services. An analysis of the Official Journal of the European Union database by Seymour Pierce shows that the value of public sector contracts won by companies such as Babcock, G4S, Serco, Capita, Mitie and Carillion has risen from £9.8bn in 2008 to £20.4bn in 2012. Seymour Pierce estimates that total public sector outsourcing could reach over £100bn by 2014-15⁹. It is fair to say that it is at this end of the market that most within social finance choose or aspire to operate.

A Market in Transition

As the public sector withdraws or is withdrawn from service provision there inevitably needs to be a process of market development as various providers, some of them totally new, seek to identify whether they are able to provide an acceptable level of service at a price which enables them to cover their costs. In the case of large private sector commercial providers operating in commonly outsourced service areas such as IT, facilities management and customer service, this is often a very straightforward process with well-resourced companies able to quickly identify the market opportunity and establish profitable business models that are capable of substantial growth.

However, as outsourcing shifts ever more in to the areas of health and social care, employment related services, criminal justice etc – i.e. services that have historically been provided by the public/ charitable sectors because of real or perceived market failure – then, by definition, it is much harder for providers to identify sustainable business models.

In these cases markets are often new or may not yet exist at all, and both service providers and commissioners may struggle to adjust to new supply, contracting and pricing arrangements. Here two things happen, often simultaneously:

1. It will often take quite a bit of time to establish who is the customer, what services they are prepared to pay for, and at what price.
2. Social enterprise will establish a new route to service delivery (which will require investment) but in doing so will either have little or no track record, or not enough financial clout to qualify for consideration. Consequently, this market for most is nothing more than a perception.

The Challenge for Social Enterprise

Identifying, developing and then growing new markets for services is challenging enough for well-established businesses and experienced managers who are familiar with the need to fund R&D in order to develop new products, taking risks on new markets and resourcing growth appropriately. These processes are incredibly difficult for social enterprises and voluntary/charity sector providers, who often do not have the benefit of extensive commercial expertise or large financial reserves. If we also then add in the shift to output-based services, paid in arrears on a payment by results basis, then the challenge of transitioning to markets for services that were previously grant funded can be nigh on impossible for most enterprises.

2. How Money is Spent To Meet Social Need

1) Bulk Provision

Provision of service targeted at the “average user” will usually focus on minimum service standards and cost-effectiveness. This is where economies of scale, back office efficiencies and well-established business models will be beneficial and commercial provision by private sector companies is most likely to be seen. Services in this category will typically be commissioned by central government or local authorities. Social businesses and charities may well operate within this segment of the market but they will tend to be the larger, more established organisations that are able to compete with purely profit-focused commercial providers, rather than smaller, local entities.

2) Preventative Spend

Some commissioners will seek to reduce overall demand for services in the long term by investing in interventions designed to prevent a need arising in the first place – preventative spend. Service providers in the preventative spend category will often come from the voluntary and charity sector, rather than the private sector or social enterprise, due to the typically long lead times required to demonstrate that an intervention has proved effective in preventing a need from arising.

The preventative spend group is aiming to reduce the level of **future** expenditure, with current provision of their service funded from the savings achieved from lower long-term need. Because of the realpolitik of public spending and the size of budgets involved, it is usually the case that cashable savings from preventative spend need to be very substantial if they are to even register with public sector commissioners, let alone “move the needle”. This type of spending therefore requires large and/or financially stable providers who are able to take on the financial risk and working capital requirements that come with such contracts. Alternatively, the use of social impact bonds, such as the one funding interventions at Peterborough Prison, provide working capital on an ongoing basis to a number of delivery organisations whose activities are coordinated by an intermediary.

3) Innovation Spend

If community based solutions are to be found to the social problems we are trying to tackle then it is important that the market does not evolve in such a way as to exclude all but the very largest providers. An accepted cause of market failure is the accumulation of significant market power by a small group of businesses, so if a different approach is required we cannot merely swap one set of large providers (the state) for another, yet this is the favoured route of the Coalition Government and a number of social financiers.

In a place of market dysfunction the more specialised provision to service users whose needs are greater than those which can be met by the “bulk” provision are more likely to be met by social enterprises and the voluntary/charity sector.

The defining characteristic of this group of providers is that they currently operate at small scale and are looking to grow: by seeking to improve the effectiveness with which products / services can be delivered by the enterprise (and therefore internal growth capacity of the business); to improve value for money for customers (and win new customers as a result); or both of these.

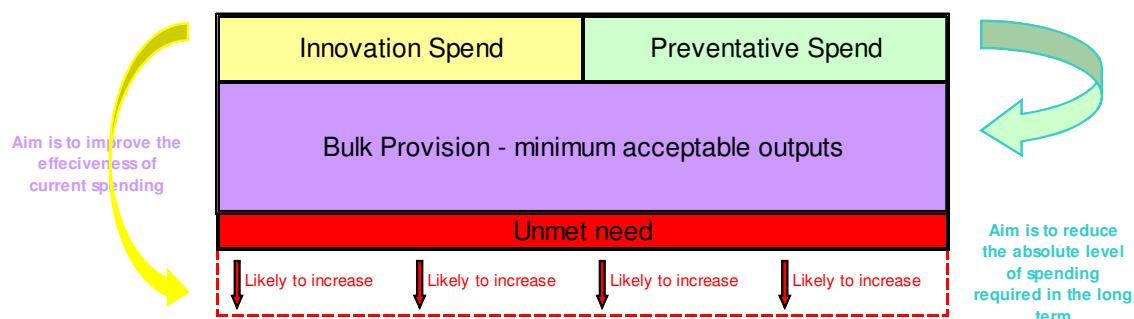
The innovation spend group in the first instance is looking simply to tackle need but with time and support are also aiming to improve the efficacy of the resources spent. To the extent that they are successful, from the point of view of commissioners they can either achieve cost savings by delivering the same or more service for a given level of expenditure, or be able to avoid cutting services to the same extent as would otherwise be necessary as budgets are reduced. Service providers in this category can grow by winning new business based on current budgets if they are able to demonstrate value for money or better outcomes than existing service providers. This type of service often grows out of entrepreneurial solutions inspired by unmet need.

4) Unmet Need

Individuals with needs that do not fall into any of these categories are likely to be marginalised with inadequate or no services provided for them. Social enterprises and charities will often use what funding they can to address the needs of this customer group but this will usually need to come from philanthropic sources. As public sector cuts take hold the level of unmet need is likely to increase.

Figure 1 summarises the position.

Figure 1 – What Money Pays For



Key point – unmet need or market dysfunction and innovation spend are the places that social enterprise occupies. Of all the markets affected by public sector cuts, these markets have been affected the most. As a consequence new types of funding will need to move into these markets, or existing funding will need to realign.

In this arena, it will take time for business models to be developed, new service providers to emerge, and understanding commissioning and procurement structures to be established. Realistically speaking, given severe budget constraints and the scale of services provision required, it is very likely that this market will be left unattended or at least initially, provided for with minimal risk resource.

This does not have to be the case, there should also be an important role for smaller, community-focused social enterprises and CVS providers who can develop new models of service delivery that are suited to the new landscape, but it will require a period of experimentation, research and development before these are of sufficient stability and scale to have real impact.

The question is how to fund the necessary development work? This is the subject of the next section.

3. Demand for social finance – key factors

Community based social enterprises will often face double trouble when it comes to seeking finance. First of all, they face the same funding issues as any small or medium-sized business. Secondly, as social innovators they may need to experiment in several dimensions simultaneously in order to meet social need via a sustainable business model, and this will bring its own funding challenges.

Small Businesses

With the intervention of ‘sector neutral’ preferences, private sector SMEs are now to be considered as competitors for social finance. This in turn will add another level of complexity to the already confused finance arrangements.

The existing difficulties that SMEs have in finding and accessing finance are much discussed and well summarised in a recent BIS Economics Paper.¹⁰ This shows that bank loans are still the primary source of external finance for SMEs. It also highlights a number of structural factors that are restricting some viable SMEs from accessing finance, including:

- Increased risk aversion at the banks plus regulatory requirements to hold more capital means less is available for lending;
- Imperfect or asymmetric information between finance providers and small businesses which means that businesses which lack collateral or a sufficient track record struggle to get debt funding;
- The amount of available venture capital has fallen dramatically since the financial crisis and so early stage businesses with high potential for growth are less able to obtain risk capital from equity finance.

The type of funding available to, and suitable for, any SME will also depend on their stage of development as a business. Given the very early stage of market development for many services designed to meet social need, as described above, it should be expected that there will be a relatively high proportion of businesses in the earliest phases of development: R&D, pilot/prototype, product & market testing, product launch & refinement. Some will be in the expansion phase but probably relatively few will have reached sustainable growth, i.e. the point at which revenues reliably cover expenses. Most private sector based SMEs will, however, have legal structures that are favoured by social finance intermediaries.

Social Enterprises

While these issues apply to any SME, social enterprises also often face additional factors which contribute to difficulties in obtaining suitable funding.

A research study by the University of Southampton found very low levels of demand for loan finance in a sample of 40 social enterprises operating in 4 English cities. This was attributed to the heritage of each organisation and a history of making do with very limited resources.

This study suggests that organisations with a long history of operating in a charitable and / or public sector funding environment have developed skills, capabilities and priorities which may be difficult or slow to change in a different operational setting. The researchers concluded that in many cases it is unlikely that social enterprises will change their financial behaviour and practices unless they are supported and guided by intermediaries who can provide knowledge about appropriate funding.¹¹ It is through this very point that we are able to pick up on why one of the more prominent gaps has appeared in social enterprise/ intermediary relationship. Namely, grant funding is important in treating need yet the social finance market has almost overnight tried to remove grants from the funding mix. It has in application been quite crude, lacked credible reasoning and has largely been responsible for the cry from large parts of the social enterprise sector that social finance is not for them. Regardless of the financial climate, community based social enterprise, especially those at the early stages of company development, will require a mix of funding that should include grants. This is explored further in the next section.

Building vs. Buying – Why the difference matters to social enterprise.

The SME finance market is about *buying*; buying into a business at minimal risk and with fixed shorter-term returns. It is this model that social finance has largely attempted to transpose across the social enterprise paradigm and where most of the conflict sits.

The different characteristics of the various funding instruments available to social enterprise – grants, patient capital, pure equity, equity-like and loans – have been well documented elsewhere and it is not intended to go into them here.

However, a key distinction that we do wish to make is whether the purpose of a particular funding instrument is to finance purchases from the social enterprise or to support the building of the organisation. *“Building an enterprise is fundamentally different from buying from an enterprise.”*¹²

Buying from an enterprise, whether that be customers paying for a product or service directly, or third-party funders paying for services to be delivered on behalf of beneficiaries, is a simple exchange of money for an agreed piece of work or activity. There is minimal risk involved in buying from an enterprise as it is agreed in advance how much money will be paid in return for particular goods and services to be provided. In the case of third party funders, grants are often the preferred funding method for buying goods and services for beneficiaries. Hence, grant funding is usually (but not necessarily always) financing for buying from the enterprise.

Building an enterprise is about trial and error to see what works, developing goods and services that meet the needs of customers, and understanding what customers will be prepared to pay for. It is a risky activity that takes time and will require “builder” finance to cover all the organisation’s costs until sufficient revenues can be achieved to meet expenses on a consistent basis – the point at which financial sustainability has been achieved. Patient capital, equity, and equity-like capital may all be used as forms of builder finance.

Builder finance is generally longer lasting than grant funding and is often focused on trying to solve a problem rather than fixing the effects of it. It can be used to fund R&D, seed funding an organisation, financing pilots and prototypes, and establishing successful business models.

So far the discussion above could have applied to any enterprise, whether they be social or not. To bring the argument right back to the topic in hand – the demand for social finance – we need to focus more on the social part of the equation.

4. What makes a social enterprise social in economic terms?

It will often be the case that the process of developing and trying out new business models to meet social needs will generate social benefit along the way. This may be in the form of direct impact for beneficiaries receiving a product or service and/or indirect benefit from the lessons learned throughout the process for the enterprise and also possibly development of the market more generally. So even during the period when the finances of an enterprise are negative, perhaps strongly so, social benefits are likely to be positive if the enterprise is indeed truly social.

This fact provides a potentially useful way to distinguish between social and other enterprises and perhaps even answer the question “What makes a social enterprise social?” If there is a clear relationship between the costs incurred by the enterprise in providing goods or services and the social value or impact generated then the enterprise can be deemed to be social. If doing more – working with additional people or providing extra services – does not result in deeper social benefit then the enterprise is very unlikely to be truly social. That is not to say that the relationship between incurring cost to provide goods or service and social value generation needs to be linear or one for one; only that there needs to be a clearly identifiable relationship between doing more and producing deeper social benefit.

It is therefore possible to devise a test to determine whether or not an enterprise is social. An enterprise is only social if there is an identifiable positive relationship between the activities undertaken by it and the social value or impact created – more activity must create more social value. If this is the case then there should also be an identifiable relationship between the costs incurred in the provision by the enterprise of products or services and the creation of social value – in order to do more the enterprise will incur more cost.

The exact relationship between costs of providing goods or services and the generation of social value is likely to be somewhat subjective and perhaps controversial in some cases. However, if entrepreneurs, managers and investors are to really understand how the enterprise adds social value it will be important to analyse and articulate the relationship carefully.

5. Analysing Social and Financial Value Creation

Assuming that there is a clearly defined relationship between costs and social value then it becomes possible to show how social value and financial value are created as a company goes through the various stages of its development.

During the earliest phases prior to product launch – R&D, pilot/prototype and product/market testing – the business will incur cost but there will be no revenues generated with which to offset them. Financial value will therefore be negative during this period. However, if this is a social enterprise then as soon as products or services are being delivered, even if this is only in the form of pilot operations or prototypes, then some social value is likely to be generated during this phase of company development. Depending on the exact relationship between costs and social value then blended value in this phase – social value plus financial value – will be zero if social value is equal to costs, or negative if social value is less than costs.

After a successful product launch then revenues will start to offset costs and eventually, if this is a financially sustainable enterprise, income from product/service sales will be sufficient to offset all costs and start to generate financial surplus. During this phase of company development financial value will initially be negative and then turn positive once revenues exceed costs. Social value will also be positive. Blended value will either be positive throughout this phase or will turn positive at some point during it depending on the timing of the move to profitability and the relationship between costs and social value creation.

Figure 2 below summarises these key concepts:

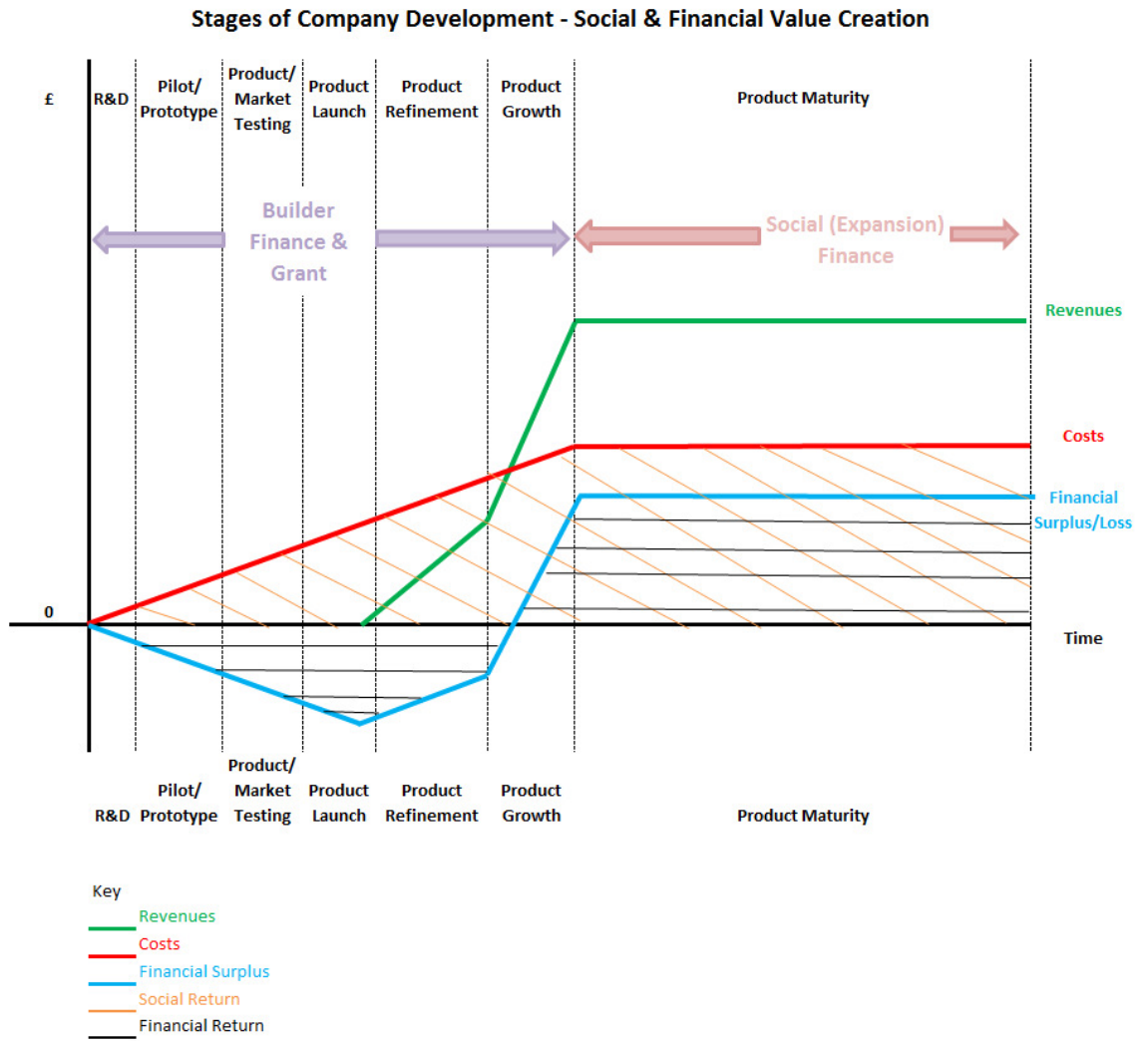
Social returns– denoted by orange shading - are positive for a social enterprise once pilot/prototypes products or services are launched.

Financial returns – denoted by grey shading - are negative throughout the early stages of company development. They turn positive only once revenues exceed costs.

Blended returns – social plus financial returns – are only likely to be substantially above zero once the enterprise reaches product maturity/financial sustainability.

Early stage social enterprises will be able to deliver positive social returns as soon as they are delivering product/service but these will be offset to some degree (perhaps totally) by negative financial returns.

Figure 2 – Social & Financial Value Creation



Source: Authors' own diagram

6. Defining the Market – Different Types of Finance.

It should be clear from the discussion above that social enterprises will require, and be able to support, different types of finance depending on where they are in the company development cycle.

Builder Finance

In the early stages, the need will be for funding that allows flexibility in order for the enterprise to take on necessary personnel and for products to be developed and adapted according to customer needs and market conditions. Using the terminology of George Overholser, we will call this “**Builder Finance**”. Returns to investors during this period will be negative in financial terms but positive when it comes to social value (for an enterprise that passes the social test). One definition of Builder Finance is therefore that providers of it are prepared to accept **only** social returns for an initial period with a high risk of capital loss. Builder financiers may be prepared to fund enterprises without requiring any financial return at all, or they may wish to provide instruments that convert into providing a financial return once the business has achieved certain benchmark performance criteria for revenues, financial surplus etc. The latter is likely to require a commitment to supply funding for a lengthy period of time and enterprises should be prepared to negotiate terms that reflect a long-term relationship with the funder.

Builder Finance is risky. But it also offers the opportunity to catalyse and develop transformational business models that can meet social need **and** deliver social and (in time) financial returns to investors.

The question is does it really exist? Of course there is philanthropy capital with all of its benefits and it may fall into the Builder category, but within the current list of social finance organisations are there any investors who would truly be prepared to offer higher risk capital in return for social returns only? Evidence so far would indicate no. Are any even willing to think of making this sort of change, with modest financial returns coming only later? Possibly not. If it is accepted that the requirement for Builder Finance is necessary we may have to search in different places to the ones we have been looking so far. We believe Big Society Capital will have a substantive lead role to play in creating the places to look.

Dan Gregory of Common Capital provides a useful summary of existing forms of risk capital that share some characteristics of Builder Finance in his document “Through The Workshop Window”¹³ but the list is short and none of the examples quoted fulfil all the requirements of Builder capital.

Social (Expansion) Finance

This is the type of funding provided by the majority of social finance intermediaries.

Once a social enterprise has reached financial sustainability then it should be possible to access a wider range of providers in order to fund expansion as the business will then be creating positive social and financial value. While financial returns may still be small, either because the business is still relatively young or due to the nature of the market they are operating in, the fact that both components of blended return will be positive should appeal to social investors who require some financial return in addition to social value. This can be termed **“Social (Expansion) Finance”** and it may include loans, equity and equity-like funding. The definition of Social Expansion Finance is that providers of it require both social and financial returns of some degree – blended returns. The precise mix between the 2 types of return will vary by investor and will fall on a spectrum with “impact first” investors at one end and “finance first” investors at the other.

Grants

Grants – funding to support particular projects or to buy specific goods or services –are always helpful at any stage of company development and indeed may be the only source of income as a new social enterprise is getting started. Grants can be defined as funding provided by an intermediary in order to buy goods or services from an enterprise on behalf of third party recipients. They are therefore distinct from Builder Finance and Social Expansion Finance as they provide revenue to the social enterprise, not capital.

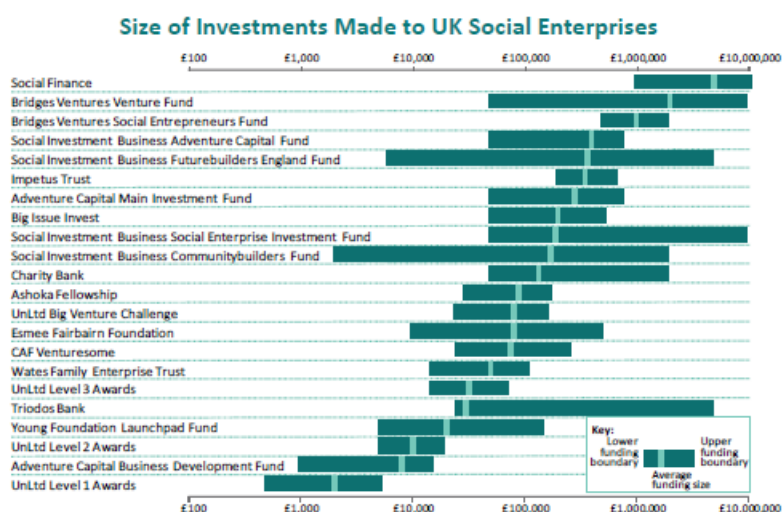
It should be noted that Builder Finance, Social Expansion Finance and grants are there to do different jobs. It is hoped that by defining terms in this way that entrepreneurs and funders alike can save much time and effort by identifying at the outset which type of funding is likely to be most suitable for social enterprises at their own particular stage of development and nature of the markets they serve.

7. Supply of social finance

Social Finance Market Overview

The total size of the social investment market was estimated to be just £165mn in 2010/11. Of that amount 84% was estimated to be secured lending, 11% unsecured lending and just 5% quasi-equity or equity. Central government was identified as providing 50%-60% of available funds, deposits at social banks such as Triodos UK, Charity Bank, Ecology Building Society and Unity Trust Bank another 25%-30%, and Trusts and Foundations the remaining 5% of the total.¹⁴

The chart below shows some of the main providers of social finance in the UK along with the average investment size:



Source: Financing Social Enterprises in the UK. The Social Investment Consultancy. March 2011

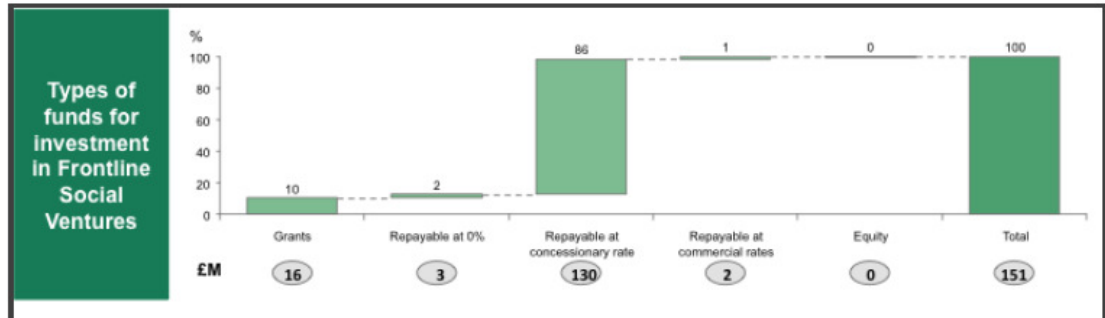
The UK Government states that it is committed to growing the social investment market and making it easier for social entrepreneurs to access capital. To that end they have undertaken a number of initiatives to increase the supply of finance for social investment. A key measure was the creation of Big Society Capital (BSC), funded by £400mn from dormant accounts and £200mn investment from UK high street banks over 5 years. BSC is a wholesale institution which invests in social investment financial intermediaries (SIFIs): organisations that provide affordable finance and support to social ventures. It does not provide finance directly to social enterprises.

The addition of an extra £600mn of funds into a market of less than £200mn will have a substantial impact. It is therefore essential to have a good understanding of the underlying supply and demand dynamics of the social investment market if we are to ensure optimal allocation of funds.

Sources and Uses of Social Finance

Figure 3.1 confirms that prior to the establishment of Big Society Capital the vast majority of funds available via the social investment market were in the form of loans repayable at below-market rates. A small portion was offered as grant funding.

Figure 3.1 – What kind of funds are on offer?



Source: Big Society Capital: Vision, mission and activities

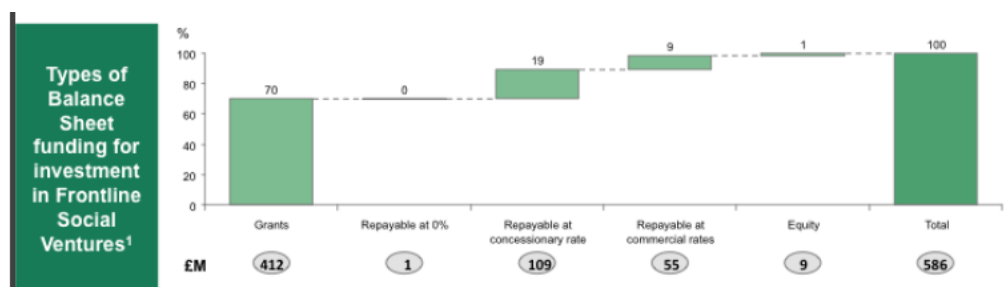
This shows that while tiny in the context of capital markets as a whole, the social investment market does serve a useful purpose for those social enterprises that are able to service debt finance. With 88% of loans outstanding from SIFIs repayable at 0%, or at concessionary rates, this puts social enterprises in a more favourable position than SMEs more generally - around half of the SMEs that access external funding most commonly use bank overdrafts, credit cards or bank loans/mortgages which will charge commercial rates of interest.

Unfortunately, unless there is a major shift in the way the SIFIs fund their own operations then this may be an issue of “buy now while stocks last”. According to Big Society Capital’s own mission document:

“To date SIFIs have been capitalised through a mixture of grants and soft loans. Recent research by BCG found that there are no wholesale funds available to SIFIs on commercial terms. Only 6% of SIFIs said that they had successfully applied for commercial funding during their last financial year. However, on closer inspection, this finance was not strictly ‘commercial’ as it was provided as part of a package with matched grant funding and claimed against CITR.”¹⁵

The situation is shown clearly by Figure 3.2 below which breaks down the sources of funding for SIFIs.

Figure 3.2 – How SIFs have been funded up to now



Source: BCG and Young Foundation (2011)

In his blog, David Floyd argues “The social investment market in the UK is currently around 80% distortion, 20% market. BSC itself is the biggest single distorting factor and grant dependant intermediaries are the second biggest.”¹⁶ This distortion together with the funding structure described above, raises the rather uncomfortable possibility that the financial intermediaries that have been established to support the development and growth of social sector organisations in meeting social need, may themselves actually be competing for exactly the same (limited) capital resources as the enterprises they are there to help.

Moreover, once funds are placed with intermediaries there is evidence of nothing more than experimentation resulting in little or no social benefit. Using the following example it could be argued that some of the intermediary group are themselves not ‘investment ready’.

“A well-known social investing network has spent years coming up with sophisticated collaborative investment schemes only to find two deals. And nobody knows how much of the funds pledged in recent years are really going into more traditional sustainable investments, and management fees, rather than into the innovative social entrepreneurs they were intended for.”¹⁷

Therefore, by putting the financial infrastructure in place before the social sector has had chance to develop properly, or by placing valuable funds with intermediaries who have had little or no previous experience of understanding the determinants of social enterprise, have we put the cart before the horse?

As the major source of funds, Big Society Capital has a very important role to play in improving the amount and variety of capital available to SIFs in order to fund their own operations and the £600mn available has the potential to transform sector balance sheets. However, it should be noted that BSC itself needs to attain financial sustainability and so the terms on which it offers capital are likely to be less generous than those offered by the primarily grant funded SIFs in the past:

“Any equity, quasi equity, risk/working capital or debt investment by BSC must be shown under rigorous stress testing to generate over time a financial and social return commensurate with the underlying risk assumed. This means that BSC will need to balance the overall levels of financial risk it takes in pursuit of social impact with the need to generate sufficient financial returns to remain operationally viable.”¹⁸

So as the social finance sector diversifies its own funding sources, largely due to the deployment of money from Big Society Capital, it is possible that the terms available on funds may tighten in the sense that average interest rates charged may increase vs. what has been offered in the past. The extent to which this happens, if at all, will depend on the social characteristics of the social investors and the extent to which they are prepared to trade off lower financial returns in exchange for deeper delivery of social value. Important to remember, though, as with social enterprises, in order to survive and thrive, social investors will need to demonstrate both social and financial sustainability so there will be limits to which such trade-offs can be achieved if current terms and conditions of BSC capital are maintained. The authors of this paper believe that if change is to appear in this market then the first significant shift will need to come from BSC.

8. What makes a social investor social? Or how to BUILD a social enterprise

The previous section talks about some of the fault lines within the social finance system. We now look at how social financiers differentiate themselves from other funders in order to justify the moniker “social”.

To warrant the title “social” surely being a little bit social or social at the margin can’t be enough to warrant a totally new asset class? We need some clear and robust criteria to define what it means to be a social investor. This probably requires distinction to be made between those investors who put capital entirely at risk in a quest to find new solutions to meeting social needs and those who are providing low-risk capital at only just below market rates whilst also achieving some degree of social impact.

By definition, to become real social investors, intermediaries need to be both investors and have a strong social requirement. In the same way that conventional financial markets offer a wide range of different financial instruments with varying risk and return characteristics, so too should a fully functioning, well-developed market for social finance. One differentiating feature of a social investor vs. a grant funder is that regardless of the type of capital offered, the investor will be seeking some kind of return from any money invested.

According to the Big Society Capital website:

“Social investment is the provision and use of capital to generate social as well as financial returns.

Social investors weigh the social and financial returns they expect from an investment in different ways. They will often accept lower financial returns in order to generate greater social impact.

Some interpretations of social investment include the provision of capital without any expectation of financial return. When we refer to social investment, however, we mean investment mainly to generate social impact, but with the expectation of some financial return.”¹⁹

The authors of this paper argue that this definition is inadequate as it fails to capture a key requirement of risk capital – willingness of the investor to lose some or all of their original money invested.

Figure 4 shows a spectrum of financial returns which includes Builder Finance where investors are prepared to accept some risk of capital loss.

Figure 4.1 – Spectrum of Financial Returns

Type of capital	Spectrum of financial returns			
	Willing to take risk of some financial loss	Return of original capital minimum	Return of original capital plus financial return	
	Some capital loss possible	Repayable at 0%	Repayable at concessionary rate	Repayable at commercial rate
Builder	√	√	√	√
Social (Expansion)	x	√	√	√

Matching Supply & Demand for Social Finance – Identifying the Gap

It is clear from the previous discussion that the greatest demand for finance is most likely to be from enterprises in the early stages of company development and so they require Builder Finance. It is important to note that this type of finance may need to be in place for 3-5 years before real returns materialise. By contrast, most of the supply of finance has been of secured lending, perhaps at concessionary rates. For those social enterprises able to service debt then social finance will be a sensible option, unfortunately there are relatively few social entrepreneurs who are in that position hence the need for the Builder Finance marketplace to be established.

Figure 4.2 – Type of Capital By Stage of Company Development

Type of capital	Stage of Company Development			
	Pre-revenue	Revenue	Maturity	
	R&D/Pilot/Product development	Revenue generation and growth	Stable revenues & improving margins	Stable revenues and flat/declining margins
Builder	√	√	√	√
Social (Expansion)	x	√	√	√

The next section looks at how that gap might be filled.

9. Filling the gaps

“When the majority of social enterprises are being turned away by impact investors on the grounds that there is no viable ‘exit option’ for the shareholders in the form of IPO or trade sale, or the risk rewards does not meet their funds hurdle rates, perhaps it is time to ask whether the problem is not in fact with the investor, wedded to one kind of investing model, rather than the investee?”²⁰

Another consideration is if much of the social finance commentary is to be accepted and only a small percentage of social enterprises are investment ready²¹, then there is on those terms, already enough money in the system. Yet take a view on need and the size of the market necessary to satisfy, even in part, that need, and we are faced with a completely different finance picture altogether.

In the simplest of terms the gap is for funding of early stage, highly entrepreneurial social innovators and it will require a significant shift from one or more finance agents to start the process off.

Figure 5 pulls together what has been discussed during the course of this paper. With an eye on the ‘shift’ it also picks up on a topical discourse promoted by the Social Investment Business and others about what would be the best use of BSC funds.

Figure 5 – Capital shift required to fully develop the social investment market

	CHANNEL 1	CHANNEL 2	CHANNEL 3	CHANNEL 4
Suggested % of BSC allocation	25%	50%	15%	10%
Source of Money for Growth	Big Society Capital	Big Society Capital	Big Society Capital	Big Society Foundation
Service Delivered By	Commercial Providers Spin-outs Public Sector Providers Large Charity	Social Enterprise	Charity with Trading	Charity
Finance Required	Social (Expansion) Finance	Builder Finance	Builder Finance	Grant Only
The Market for Social Need	Bulk Provision - Minimum Acceptable Outputs & Preventative Spend	Innovation Spend & Unmet Need	Unmet Need	Unmet Need
Current Sources of Money	Social Finance & Income From Trading	Grant & Income From Trading	Grant & Income From Trading	Grant & Income From Government Contracts

Diagram details: A red vertical bar labeled 'Firewall' is positioned between Channel 1 and Channel 2, and between Channel 3 and Channel 4. Arrows labeled 'Needs to Shift' point from Channel 1 to Channel 2, and from Channel 2 to Channel 3. Upward arrows in the 'The Market for Social Need' row point from 'Current Sources of Money' to 'The Market for Social Need' in each channel.

Explaining the diagram still further, we draw the following conclusions from this.

Channel 1. The place of Social Finance.

Most of the current payments for provision of services to meet need go to commercial or public sector providers (including spin-outs) in order to provide a basic level of service. If current estimates/targets are to be accepted there is roughly £1bn of finance circulating in this channel. Services are largely output driven with an emphasis on lowest cost perhaps including an element of preventative spend. This part of the market is the only one where service providers have business models that are able to take on Social Expansion Finance and it is where virtually all of the currently available social finance is invested.

To date, community based social enterprise has been misguided in thinking that this money is for them, when most of it is not. Also, intermediaries, with a range of motivations, have encouraged the same social enterprises to bid, wasting time, resources and ideas. This requires change and an honest repositioning from all concerned.

A firewall is shown in figure 5 between the first two channels/ markets as the authors believe that these 2 “pots” of money should be kept distinct. Channel 1 is for commercial & public sector providers who are financially sustainable and are usually perfectly capable of supporting Social Expansion, or even commercial finance. If they were to move into Channel 2 to take Builder Finance then these businesses would crowd out social enterprise from the social finance market.

On the other hand, social enterprises that are in the early stages of development, are innovative and have yet to reach financial sustainability will be wasting their time by going to funders in Channel 1 because they can’t possibly hope to generate positive financial value in the short term.

Channels 2 & 3. The place of social enterprise and Builder Finance.

Social enterprises that are looking to provide innovative new delivery models and tap into unmet need currently rely heavily on grants to fund their operations. Grant funding will always have an important role to play in supporting service delivery and stimulating revenue growth in the very early stages of the enterprise’s development. However, social enterprises primarily need Builder Finance in order to develop and grow their operations as they are generally early stage businesses that cannot support the financial returns required by providers of social expansion finance – this period can often stretch up to and beyond a 5-year period. We believe that this is where the largest gap exists between supply and demand for funds. Neither SIFIs nor Big Society Capital are currently involved in providing funds in this part of the market and yet this area has the greatest need for such funding. To stimulate a change that moves closer to creating a model that delivers builder finance, we will later suggest that BSC allocate 50% of their funds going forward into the activity contained in this channel. *

** Not covered in this paper but worthy of consideration: A potential partner in this channel is the Big Lottery Fund which is currently considering how it may go about “strengthening and increasing the capacity of the social investment market for supporting public benefit and social action.”²² Any Lottery intervention could be positioned to overcome the social finance fixation with ‘first loss’ and risk, allowing for greater flexibility in allocating BSC resources in the manner suggested.*

Channel 4. The important role of charities – both big and small

Markets have their place but they are not the be all and end all, as some would have us believe (and recent economic events have proven). We cannot leave everything to markets because it is not a level playing field out there. Markets can help, but alone they are not the solution and can even hurt the poor – thus markets have to be managed to ensure the poorest get a look in²³ and, in the worst cases, are looked after.

Getting a look in/ looked after remains a vital link in the structure of any caring society. Large/small charities delivering government contracts and/ or funded purely by grants are part of the market for social need. They are a distinct but still important part of the landscape with quite separate funding requirements. In addition, we have noted above the important role of grant funding, even for social enterprises looking to achieve financial sustainability.

While Big Society Capital currently receives all the attention in the social investment market, is there a role here for The Big Society Foundation “which will be constituted to receive charitable donations and develop complementary grant programmes to support BSC’s mission”²⁴ ? The Foundation has not yet been formed and it is not clear when it will or how it will be capitalised when it is. There was no mention of it in the recently published BSC Annual Report for 2012. We would argue that there is an important role for the Foundation in encouraging philanthropic money into the social investment market, perhaps on a matched funding basis.

The complementary role of builder finance and grant – buying vs. building

Builder finance and grants do very different jobs but they are both important, especially in the early stages of a social organisation’s development.

A social enterprise that is both socially and financially sustainable must be able to fund provision of products/services and meet ongoing growth and development needs of the business. The proportion of “buying” vs. “building” finance will vary according to the nature of the enterprise and its stage of development – the ratios below are indicative:

- An early stage social enterprise will require some grant funding to pay for service delivery to generate / kick-start revenue growth, with a higher proportion of builder finance to fund initial business development - say 20% grant to 80% builder finance.

- A smaller charity looking to establish a trading entity will require a much higher proportion of grant funding to support service delivery with some builder finance to allow trading operations to be developed – say 80% grant to 20% builder finance.

The Big Society Capital Group needs to perform a wider role if it is to achieve its social mission

The first part of Big Society Capital’s mission is

“To have a transformative impact on the social investment market in the UK by supporting social investment finance intermediaries to become financially robust and able to:

Attract greater and more diverse sources of investment;

Effectively and efficiently channel appropriate and affordable capital to the social sector; and

Provide effective financial and business support services to the social sector.”²⁵

The authors of this paper argue that while BSC has made a useful start, there is still much to do. There are large and important gaps in the social investment market yet to be filled. In particular, we believe that for small early stage social enterprises there is no current provision of ‘appropriate and affordable capital’. Accordingly, if the current intermediary mindset prevails, there is a real risk in the medium term that *need*, and its creator – *poverty*, will be left untouched. There will be a point at which the costs associated with treating need are deemed too prohibitive. We are not there yet and with time to plan for adequate interventions, this situation can be avoided. However, to avoid this, substantive imminent change is required.

We urge the Boards of The Big Society Trust and Big Society Capital to think more creatively and expansively about the crucial role that they can perform in supporting early-stage social enterprises and charities who are developing trading arms, in obtaining the right sort of capital. We would also like to see formation of The Big Society Foundation as soon as possible with a view to it working alongside the philanthropic sector in order to ensure that all parts of the market for social need have the opportunity to have their funding needs met.

In 2009/10 around £2bn of grants were given out by charitable trusts and foundations, £0.5bn by Big Lottery (who have a bigger role to play in the social investment market but have yet to decide precisely how), £750mn by private sector companies, and just under £8bn donated by private individuals, for a total of over £10bn.²⁶ Research by Coutts Institute identified 232 charitable donations worth £1mn or more in 2010/11, with a combined value of £1.2bn.²⁷ Even if only 5% of total grants and donations were to be allocated to providing builder finance that would still represent an annual **flow** of funds which is almost the same as the total **stock** of outstanding social finance of £0.6bn. With the help of BSC in developing suitable financial instruments and promoting best practice and sharing information, it should be possible for all parts of the market to access appropriate and affordable capital.

In addition, there is a vital role to be played by BSC Group in engaging with the wealth management industry and those high net worth individuals who may not see themselves as

philanthropists but who may well be very interested in participating in, and funding, the development of innovative solutions to meet social need. Without meaningful dialogue on what the social issues are, which are the social enterprises with the best ideas, and what are the most appropriate financial instruments that can connect investors to the entrepreneurs in a mutually beneficial way then it is unlikely that the markets for social need or social investment will ever fully develop. The BSC Group is uniquely placed to bridge the gap, create and sustain the dialogue and facilitate the development of new financial instruments that will meet the capital needs of all social enterprises, whatever their stage of development. BSC has a crucial role to play as a market maker as well as an investor and we would like to see more leadership from them in facilitating better matching between the enterprises that need capital and the investors who can provide it. After all, this is the only way that the social *investment* market will be able to thrive, and BSC will be able to achieve its own vision, mission and objectives.

Returning back to making the Channels of Fig 5 work, and in order to stimulate the debate, we would propose that The Big Society Capital Group should consider allocating capital in the following proportions to the various parts of the market:

- 25% to fund bulk provision of service providing minimum acceptable outputs and preventative spend;
- 50% to fund innovation spend and support community based social enterprise development, looking also to lever in philanthropy investment.
- 15% for the provision of unmet need by charities via trading activities
- 10% by The Big Society Foundation to fund grants for charities serving unmet need purely from charitable activities.

Conclusions

Given all that is being discussed here and as all of us face out to a worsening set of social characteristics, it is worth drawing on the thoughts of Bill Drayton from Ashoka – recognised worldwide for his entrepreneurial intelligence.

The next big idea in moving the field is the "Framework Change," In Drayton's view, to fix our broken systems, we need to accelerate the number of change makers in the world.

Which of course returns us to innovation, and in turn returns us to the risk investment necessary to support the change makers who are already out there and ready to take part. Who amongst the social finance sector will take the lead on the transition and who will follow? We are hoping this paper and other thinking with similar positions will start to prompt debate and, who knows, maybe even create change makers from within the intermediary group.

Using a further example from Drayton, he lays out the social entrepreneur landscape that the social finance fraternity either misunderstands, or, so far, appears to ignore.

"Social entrepreneurs need and deserve loyalty. Their work is not a job; it is their life. And they are, day by day and year after year, central to the iterative process of creation that is the essence of the value being built. But making and sustaining the commitments that would constitute loyal partnering requires judgment, very-long-term perspective, and true understanding of entrepreneurship—all of which are difficult for large institutions to muster.

*Social entrepreneurs need medium- to long-term and often substantial investments. They must test and refine an idea (an inherently unpredictable process), learn how to market it and cause many other institutions to change (also resistant to tight scheduling), and then build an institution and movement."*²⁸

Social entrepreneurship is a complex issue. The current sources of money find this complexity difficult to come to terms with when appropriating funds. Given this, a key route to improvement for all parties is to look for the solutions from the perspective of the entrepreneur/ enterprise. Currently the way funds are appropriated is counter-intuitive to the needs of the social enterprise sector. This means that the finance dialogue is floundering and dissipating into nothing more than opposed positions that have the potential to lead to entrenched enmity. If this happens it will serve nothing and nobody.

Right now we know that as public spending cuts continue to bite the landscape of service provision to meet social need will continue to evolve and change. It is likely that large private sector providers will see their share of contracts grow and there is already large and growing risk that social sector organisations become increasingly marginalised if scale economies and back office efficiencies are seen as the main source of achieving savings. Furthermore, as the social enterprise movement continues to be re-shaped with 'sector neutral' being one of the latest interventions, there is a fear that existing legitimate social enterprise will be pushed further away from the investment pool.

UnLtd published their direction of travel in this area by announcing that of those shortlisted for the Big Venture Challenge over 60% were from the private sector.²⁹ It is a curious and potentially wayward experiment.

Looking for positive signs, other social finance agents have taken the stance that their money is in fact as we describe in this paper – for services that are for the less needy – a stance that is summarised in the following paragraph.

“To get the most out of our money, a critical discipline in today's capital-starved times, and generate the most social impact, we need to start with the least needy and work our way backwards. This may seem perverse, but for those who care about substance over form, and making a substantial impact over a huge gesture, it is essential.”³⁰

This statement is positive because it draws a line in the sand, demonstrates intent and may in the long run prove correct, who knows? But it relies on there being a great deal of time to play this particular model out and with no guarantees as to whether intermediaries can deliver (and so far evidence is at best patchy). It is clear that the intermediaries want the social enterprise movement to trust them to get there (with no measure of where *there* is), and all around poverty deepens and public money, once there for social enterprise to access independently, is now being re-directed into social financiers who themselves have little or no proven track record of delivery. This direction on its own is also curious and another potentially wayward experiment.

In many inner city areas, market dysfunction was already apparent before the crash and the response of austerity. As austerity has gripped, new and deeper aspects of dysfunction are appearing across the same and other communities. Youth unemployment is at crisis levels, having reached the million mark³¹ and there has been a rise of 170% in people reliant on Food banks and handouts.³² With scant evidence that mainstream welfare provision can alter these and other similar conditions of need, it is vital that social enterprises are given investment to enable them to provide innovative solutions to social problems.

With a 30 year history of activity here in the UK, social enterprise is still a developing and largely experimental market at the moment and the organisations that operate within it are often small and at a relatively early stage of development. Many social enterprises operating in these markets will not be in a financial position at present to support the payment of short-term financial returns but they will be able to demonstrate that they can deliver solutions to need. The development and growth of social enterprises like this into sustainable businesses capable of delivering both social and financial value over the long-term will require entrepreneurs and investors to be clear and honest about their respective requirements as well as to be specific and careful what they ask for when it comes to discussing funding.

Where this is the case much time and effort could be saved by directing requests for funding only to those investors for whom social returns alone are an acceptable pay-off in the short-term (assuming such investors can be found). Of course, the assumption must be that financial returns will ultimately be required, regardless of how patient the investor, and so a credible pathway to both social and financial sustainability needs to be included in any request for funds. Similarly, social investors that are offering funding which requires regular financial payments such as interest or where original capital must be repaid within a short period of time could also helpfully be very clear about the relative priorities to them of financial vs. social returns.

This paper has provided some tools in fig 2, fig 4.1, fig 4.2 and fig 5 which it is hoped will help entrepreneurs and investors clarify where they fit in to the social finance landscape. A clear understanding of what is required, when, and by who on the demand side, together with a good picture of what is available on the supply side should facilitate a more efficient matching process than that which takes place at the moment.

Of course, supply and demand for anything can only be effectively matched if there is more or less a balance between the two components. Unfortunately, in the case of social finance, while there appears to be a good supply of debt funding requiring sub-market or market returns suitable for relatively stable or mature businesses, most of the demand for funds will, and is, coming from much earlier stage enterprises that require a different type of finance altogether.

The launch of Big Society Capital is an invaluable step forward for the development of the social investment market in the UK. However, as we have suggested in this paper, the way it is currently distributing its funds is not sufficient to provide all the funding that is required by the many small or early stage social innovators that are still trying to develop market-based solutions to some of the most difficult social problems the country faces. Without it there is no evidence that change will appear and for that, a new approach is required.

The newly published BSCG annual report makes an interesting read and we must wait to see the direction of travel BSC take post 2013. The authors of this paper urge the Board and management of BSCG to consider the important gap in the market for finance for community-based, early stage social enterprises that we have identified. The larger majority of the incumbent intermediaries have no interest in this space, although they would claim to do so. We believe by working alongside the philanthropic sector, The Big Society Capital Group has a crucial role to play in building enterprises that are socially and financially sustainable that will, as a result, be able to meet social needs much more effectively, and for longer, than current models could ever hope to.

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For more information about Can Cook please visit www.CanCook.co.uk

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