

# **ACCESS TO CAPITAL**

**A briefing paper**

**Venturesome**

**September 2009**

**Charities Aid Foundation** (CAF) is a registered charity that works to make the most of money for charities and social enterprises. CAF believes that access to capital is vital for a healthy and thriving charitable sector.

Over the years CAF has been instrumental in pioneering and incubating funding solutions; including Venturesome, a high-risk investment fund and Charity Bank, which became independent in 2002.

**Venturesome** provides capital to charities and social enterprises, operating in the space between providers of charitable grants and providers of bank loans at market rates. Since its launch by CAF in 2002, £15 million has been offered to 250 organisations. In addition to accumulating practical deal experience, Venturesome has endeavoured to have a central role in building a robust social investment market, adopting an open-book approach to share knowledge and build experience, but also ready to operate in competition so as to raise standards.

For more information, visit [www.venturesome.org](http://www.venturesome.org). If you wish to receive information from Venturesome, please send your contact details to [venturesome@cafonline.org](mailto:venturesome@cafonline.org).

#### **About the authors**

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## Preface

This paper is an update to Venturesome (2008) *Financing Civil Society*<sup>1</sup>, prompted by the Office of the Third Sector's consultation regarding a Social Investment Wholesale Bank. It was written as a discussion paper, providing context for a CAF-hosted roundtable held in August 2009.

There was consensus at the roundtable regarding this paper's proposed four key pillars to a robust social investment market, and a positive discussion ensued as to how a social investment wholesaler might contribute to building those four pillars. Some key questions emerging from that discussion are included at the end of this paper.

We publish this paper as a contribution to the current thinking on social investment, and the role that a Social Investment Wholesale Bank might play in supporting the existing ecology of this emerging and still fragile market.

## Introduction

It is increasingly recognised that lack of access to capital is acting as a barrier to charities<sup>2</sup> achieving their social mission.<sup>3</sup>

There is limited quantitative research on the capital need of charities, but ample case studies of charities struggling to manage working capital, deal with the unexpected and invest in innovation, growth and development.

This paper paints in broad brushstrokes a picture of the current situation and outlines the characteristics of a 'robust' social investment market. By robust market, we mean a world in which informed charities have access to appropriate capital, from a resilient capital supply, distributed using a variety of financial mechanisms.

We believe there are four critical pillars to a robust social investment market:

- 1) confident and informed demand from the voluntary and community sector (VCS)
- 2) efficient matching of supply and demand
- 3) variety of investment mechanisms
- 4) resilient supply of finance

Each of these are explored in turn in this paper, in each case, laying out the following elements:

- where we are now
- characteristics that would be evident in a robust market
- key barriers to progress towards that robust market
- some emerging ideas and solutions

We invite comment on the subsequent sections of this paper. The paper is by no means comprehensive or exhaustive, and suffers from bias (reflecting as it does a social investor's perspective). The purpose is to provide a framework for discussion, debate and reflection.

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<sup>1</sup> Available at [www.venturesome.org](http://www.venturesome.org)

<sup>2</sup> In this paper 'charities' or 'voluntary and community sector' (VCS) is used as a catch-all term for the broad range of social purpose organisations, as identified in Venturesome (2008) *Financing Civil Society*. See *Figure 1*, p.6.

<sup>3</sup> NCVO Funding Commission initial findings, Office of the Third Sector (July 2009) *A consultation on the functions and design*

## 1) Confident and informed demand from the voluntary and community sector (VCS)

### **Current situation: an undercapitalised but inarticulate VCS?**

The need for access to capital is increasingly recognised by sector commentators. Traditionally, sector research has focused on income and expenditure patterns across the sector, with less attention paid to charities' balance sheets. The exception has been high level research undertaken first by the Commission on Unclaimed Assets and more recently NCVO<sup>4</sup> which highlights that the bulk of the sector has a relatively low level of reserves.

However, there is no strong or coherent voice clamouring for access to capital, other than a handful of sector intermediaries<sup>5</sup> and specialist lenders themselves. It is possible that the need for capital is simply an as yet poorly defined subset of the wider funding issues facing the sector,<sup>6</sup> which are well rehearsed.

It could be that an open debate about the need for and access to capital has been obscured by the focus on social investment/alternative forms of finance, particularly the provision of loans, as opposed to why such a form might be needed and/or appropriate. In any event, the greatly increased supply of loans, from specialist lenders such as Futurebuilders, has undoubtedly moved the debate forward.<sup>7</sup>

But many, if not the majority, are not willing to take on loans – genuine aversion to debt finance is not uncommon. The focus on loans, rather than a wider debate regarding access to capital, may not be helpful; particularly during a credit crunch largely understood to have been caused by inappropriate lending.

### **Characteristic of a robust market: a confident and financially literate VCS**

Generally, the sector would benefit from recognition that all organisations need capital (as do individuals), whether internally generated or externally accessible – not just for-profit models, or social enterprises, or charities that trade.

For a robust market, we need a VCS that is:

- confident<sup>8</sup> in identifying its own financial needs
- aware of different mechanisms (grants/loans/equity) available to support those needs, and the associated risks
- aware of different providers (from income to capital suppliers), and their motivations
- confident in seeking appropriate capital from a variety of sources
- for this, the sector would arguably benefit from stronger finance functions, i.e. financially confident CEOs/Directors/trustees, and a greater pool of chief operating officer/finance director / treasurer-types attracted to the sector

Many of the characteristics above would need to be mirrored in funders, both institutional (foundations, government) and individual donors (particularly high net-worth individuals):

- Funders able to distinguish between income and capital

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<sup>4</sup> NCVO, Guidestar research shared at the recent 2009 Recession Summit (June 2009), taken from the NCVO Almanac 2009.

<sup>5</sup> Namely, NCVO and ACEVO – which, admittedly, are representative bodies, but on this particular topic seem to be taking a lead rather than being 'pushed' by members.

<sup>6</sup> Reflected in the fact that the NCVO Funding Commission has picked access to capital as one of its three focus areas.

<sup>7</sup> Futurebuilders has stimulated demand, through a combination of scale/PR, the carrot of grant money alongside loans, and the advice and support provided by the programme.

<sup>8</sup> Conversations with NCVO Sustainable Funding Project indicate that confidence is currently a major barrier.

- Recognise different capital needs (fixed assets, working capital, rainy day reserves and growth/development)
- Identify themselves as givers/shoppers/investors<sup>9</sup>, and adopting the funding tools commensurate with their chosen role - either in-house, outsourced or in partnership

**Key barrier: cultural tension**

The importance of building up and maintaining reserves may well be recognised by charities, but invariably is not prioritised. It is quite common for small- and medium-sized charities (the bulk of the sector) to run on a 'cash in, cash out' basis. This is, in many ways, perfectly understandable: charities exist to help their beneficiaries, and the priority of the charity is meeting the needs of those beneficiaries. Money is a means to the end of helping beneficiaries – which is often translated into every penny received should be spend on direct activities.

This view is the popular one. The general public can be sceptical of reserves<sup>10</sup>, in the same vein as they are sceptical about administrative costs. As can be individual donors, as well as institutional donors, including some foundations and sector commentators.<sup>11</sup> These views influence charities. Not only is there is little external pressure to prioritise capital, indeed charities may even be discouraged from doing so by perceptions of 'unreasonable' levels of reserves.<sup>12</sup>

The issue runs deeper than donor perceptions. Research into finance in the arts world highlighted that some arts organisations see a financial deficit as a badge of honour; '*one measure of the excellence of the artistic product is the size of the deficit*'.<sup>13</sup> This tension is not unique to the arts sector. It is not hard to uncover through discussion with charities or the wider public the suspicion that financial strength, or aiming for a surplus as opposed to break even, is somehow inconsistent or even incompatible with social mission.

Grants and donations are the lifeblood of charities, and will remain critical to the future health of the sector. They are the form of funding charities are most comfortable with. Yet grants and donations are a finite resource, and therefore it is important to use grants where they are most needed.

There are a variety of reasons behind the sectors' preference for grants, beyond familiarity, including:

- The lack of recognition, mentioned previously, of a distinction between different types of money – the basic income/capital distinction, the various forms of capital need, and how these are best met (using different financial mechanisms).
- The perception that grants and donations are 'free money'. This ignores the fact that such money is rarely free. Establishing the costs of raising funds, sector-wide, is very difficult, but in the UK most charities find it costs between 15 and 25p to raise £1.<sup>14</sup> Finally, the costs of reporting on the grant can be high; one research report identified that the average cost of the reporting burden ran to 6% of the original grant, over and above what the charity would spend on its own reporting.<sup>15</sup>
- In some quarters, a sense of entitlement, along the lines that charities do good work and should therefore be *given* the money.

<sup>9</sup> As identified in Julia Unwin (2004) *Grant-making tango*

<sup>10</sup> Most recently seen in the lack of support for charities claiming compensation for funds invested in Iceland.

<sup>11</sup> For example, Charity Navigator in the US; see [www.charitynavigator.org/index.cfm?bay=topten](http://www.charitynavigator.org/index.cfm?bay=topten)

<sup>12</sup> An acceptable level of reserves is usually seen as being equal to three months worth of expenditure, with significantly more or less giving rise to concern. This rarely takes into account the make up of the charity in question's balance sheet, however, or its activities and therefore its particular capital needs.

<sup>13</sup> New and Alternative Financial Instruments, final report of Mission, Models, Money programme, available at [www.missionmodelsmoney.org.uk](http://www.missionmodelsmoney.org.uk)

<sup>14</sup> Charity Facts website, [www.charityfacts.org/fundraising/fundraising\\_costs/index.html](http://www.charityfacts.org/fundraising/fundraising_costs/index.html)

<sup>15</sup> NPC (2008) *Turning the Tables in England*

- Scepticism regarding the motives of suppliers of alternative forms of finance. Why do specialist banks and lenders, and those who invest in such institutions, do so? Are they really interested in supporting charities in their mission, or are they interested in getting their money back, or indeed are they getting involved because they are aiming to make money?

### Emerging players and ideas

Generally speaking, there seem to be fewer initiatives in this particular 'pillar' area than in others. One approach has been to argue that a steady stream of capital supply will unlock demand. Arguably supply on its own is proving insufficient, and proactive demand-focused initiatives are required.

Below are some of the ideas underway for tackling some of the issues identified above.

- The NCVO Sustainable Funding Project, which has been running for several years, takes alternative finance to the sector through open access tools and training. The latest phase is focusing on training intermediaries, across the UK. [www.ncvo-vol.org.uk/sfp/](http://www.ncvo-vol.org.uk/sfp/)
- Mission, Models, Money (MMM) New and Alternative Financial Instruments (NAFI) pilot has been forging a path in the arts sector: [www.missionmodelsmoney.org](http://www.missionmodelsmoney.org)
- The downturn, funding permitting, may provide the opportunity to recruit those with financial skills from other sectors. The Institute of Chartered Accounts for England and Wales has launched a 'Talk Charity' website, in recognition that members have or may have interests in supporting charities. [www.ion.icaew.com/charity](http://www.ion.icaew.com/charity)

## 2) Efficient matching of supply and demand

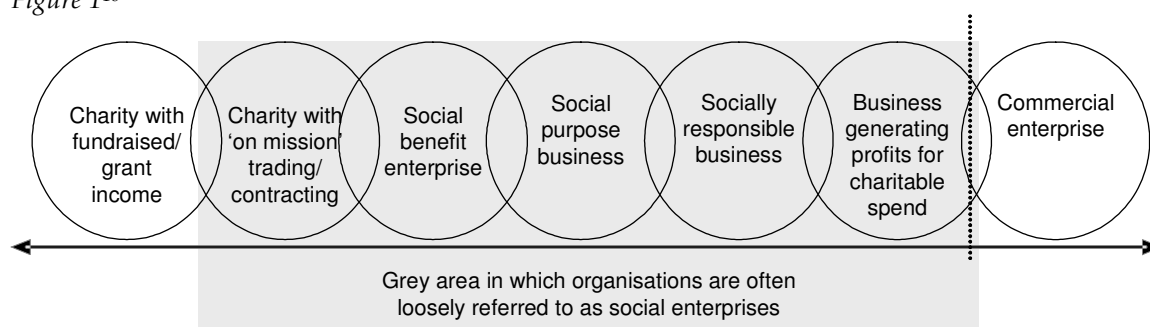
### Current situation: inefficient meeting of supply and demand

The limited understanding of the need for capital is the first barrier. But once charities and funders have identified capital needs, there are further barriers.

There is something of a disconnection between revenue funders and capital investors. The world of social investment operates on the margins. This is reflected in the language; 'alternative' finance, as opposed to 'mainstream' funding. It is often, wrongly, conflated with social enterprise - another separate sphere of activity, which is seen and sees itself as distinct from 'charity'.

On this theme, it is worth reiterating that capital is required across the spectrum of organisational forms (indicated in *Figure 1*), and that that capital need can be met using a range of capital investment mechanisms. In other words, 'alternative finance' is not just for trading organisations. It can be of use to charities that rely exclusively on grant funding.

Figure 1<sup>16</sup>



Supply itself is fragmented. Suppliers of capital do not always recognise themselves as operating in the same space or to the same ends; supply is more easily categorised by type of product offered rather than by motivation or intent. This means that institutional and individual donors, as well as intermediaries, do not always recognise where they could signpost demand, or when they may learn from one another or co-invest. To return to an earlier point, indeed, some revenue (grant) funders are unknowingly or unwittingly providing capital investment, while capital investors can end up subsidising revenue.<sup>17</sup>

Even if supply wasn't so fragmented, the routes to market evident in commercial markets are few and far between in the VCS. There are no real connecting mechanisms, beyond directory listings and ad hoc, informal signposting between specialist lenders. These issues are symptomatic of a young and immature market. The offer from suppliers in recent years has evolved, and swiftly. A clear product offer (i.e. 'loans at 6%') has only relatively recently emerged (largely through big suppliers, namely Futurebuilders). It has therefore been difficult for charities, and referring agencies, to establish who provides what.

The result is that organisations which could benefit from the increasing supply of capital are not doing so, whilst suppliers are distracted by inappropriate demand. There is anecdotal evidence of charities 'shopping around', an encouraging sign, except where it is ill informed and inappropriate, wasting time and effort of both charities and suppliers.

<sup>16</sup> Taken from Venturesome (2008) *Financing Civil Society*

<sup>17</sup> For a discussion on the commingling of revenue and investment, see Olverhoser (2004) *Nonprofit Growth Capital: Defining, Measuring and Managing Growth Capital in Nonprofit Enterprises. Part One: Building is not Buying*

Charities need timely access to capital, not lengthy application processes and opaque decision making. Again, confidence in spotting need and identifying appropriate mechanisms should help speed up these processes.

### Barriers

- There are few clearly defined and universally understood terms in the world of capital investment. The jargon of investors can be alienating for charities, while the jargon of the VCS can be alienating for more commercially-minded investors. Individuals and institutions can find themselves talking at cross-purposes through lack of agreed terminology.<sup>18</sup>
- The lack of informed demand means suppliers spend time 'educating' charities in one-on-one situations, which is inefficient. Business advisers, sector intermediaries and fundraising experts need to be equipped with knowledge and tools to help charities find help.
- Differing motives (i.e. commercial/philanthropic) on the part of suppliers can result in suspicion and wariness. Also, intermediaries (Community Development Finance Institutions, specialist lenders) compete for investment to distribute, as capital investment is in limited supply (we return to this point later). These two factors can impede working together (learning from one another, co-investment, syndication) and effective signposting.

### Characteristics of robust market: Efficient meeting of supply and demand

- Informed, confident and appropriate demand and supply is a prerequisite
- Timely matching of demand and supply – financial difficulties become exacerbated when not met when required
- Transaction costs need to be kept as low as possible. This applies to administration, assessment, monitoring and evaluation and ongoing fund management.
- Transactions also need to be as simple as possible; the challenge is to ensure innovative mechanisms are understandable and that suppliers of capital remain approachable.
- Informed intermediaries (e.g. Capacitybuilders, local CVS's) and business advisers of quality
- Corporate finance-style advice available
- Supply side actively promoting co-investment/layering/signposting
- Virtual or actual connecting mechanisms, between suppliers but also to connect them direct to demand

### Emerging players and ideas

- NCVO's Funding Central, a website of funding and investment opportunities which aims to go beyond a directory listing, helping charities navigate different mechanisms and suppliers. [www.fundingcentral.org.uk](http://www.fundingcentral.org.uk)
- There is an opportunity to build on the Social Investment Market Group, chaired by Venturesome, and develop an active forum for co-investment and syndication
- NESTA has provided finance for advisors/investment readiness work – via UnLtd Advantage (see below) – as part of its Methods Lab strand of work. [www.nestalab.org.uk/methods-lab](http://www.nestalab.org.uk/methods-lab)
- UnLtd is directly engaged in investment readiness work through its Ventures and Advantage programmes, supporting social enterprises looking to scale. [www.unltd.org.uk/template.php?ID=13](http://www.unltd.org.uk/template.php?ID=13)
- Futurebuilders is piloting a consortia approach (i.e. pulling together suppliers/advisers) to support charities interested in working together to win public sector contracts. [www.futurebuilders-england.org.uk/what-we-offer/services/pilot-consortium-to-help-the-third-sector-win-contracts](http://www.futurebuilders-england.org.uk/what-we-offer/services/pilot-consortium-to-help-the-third-sector-win-contracts)

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<sup>18</sup> Recent market research undertaken by Venturesome indicated that among three distinct groups – donors/investors, intermediaries and charities – understanding of 'social investment' was limited, most starkly among charities themselves.

- Social Finance is working with a handful of charities in a corporate finance role, helping structure and broker capital investment. [www.socialfinance.org.uk](http://www.socialfinance.org.uk)
- Several virtual connecting mechanisms are in various stages of development (and with varying degrees of success):
  - ClearlySo is an online marketplace for social enterprises and investors: [www.clearlyso.com](http://www.clearlyso.com)
  - Social Finance more recently launched a Social Investment Hub, a searchable directory aimed at bringing together those providing funding and those looking for funding: [www.socialfinance.org.uk/sihub](http://www.socialfinance.org.uk/sihub)

### 3) Variety of investment mechanisms

#### **Current situation: increasing but limited range of financial mechanisms in use**

The sector is dominated by grant funding, both in terms of the amount of supply and the cultural dominance of this form of funding, as discussed previously. On occasion, grants are used where an alternative tool may be more appropriate/efficient.<sup>19</sup> There is a finite supply of charitable money, and insufficient to go round – a situation which will only worsen in the coming years. Therefore, the efficient use of those funds becomes imperative, to ensure that grants are used where most appropriate.

No research has been undertaken that decisively maps the availability of capital (how much, in what forms, from where). Venturesome<sup>20</sup>, and more recently Social Finance<sup>21</sup>, have attempted to capture the different forms of capital in use, based on observation.

The majority of capital funding available is for fixed assets. This applies to both capital grant funding (from foundations, institutions, etc) and loan finance. Borrowing to buy a building, in the form of a mortgage, has become more ‘normal’ among charities. This has principally come from clearing banks, although there is anecdotal evidence to suggest reducing appetite from banks in recent times.

There is some evidence of banks providing secured lending for more general purposes, although this of course relies on charities having assets (or directors being willing to provide personal guarantees) – and we know charities are undercapitalised.

The handful of other mechanisms available – underwriting, unsecured loans, quasi-equity, equity – are barely used. Furthermore, where they are used, they are available in the short- to medium-term (over three to five years). The exception is long-term, secured loans (i.e. mortgages). Little genuinely patient capital/soft loans are available, yet such finance would seem necessary in a sector in which success is rarely achievable in the short-term (tackling poverty, improving education, etc).

Financial mechanisms in use have been adapted from commercial use and rarely take into account the ‘social return’ element of the investment. Social return is assessed in wildly different ways, by charities themselves as well as by social investors. Investors take different approaches to assessing risk, return (financial and social) and how their pricing reflects that. Few are transparent about their approach, making it difficult for charities, among others, to assess who is providing what and why. Indeed, the pricing of investment rarely links coherently to the expected social return of the investment, leading to confusion.

A framework capturing risk, financial return, social impact and pricing is not yet available to us. The first step is for donors and investors to recognise their appetite for risk, and how far they are prepared to go with their money in order to achieve the(ir) desired social impact.

All donors and investors, whatever their approach, have a particular risk appetite determined by a number of factors, not least their expectation of financial/social return. Across their portfolio of investments/grants, they will be aiming for a pre-agreed overall level of financial/social return. Grantmakers, for example, take 100% risk on their grants – they will never see those funds again – but this is accepted as it is being traded for social return. Social investors (such as community development finance institutions), on the other hand, seek a financial return – usually the aim across the portfolio is to at least recover the capital so that it

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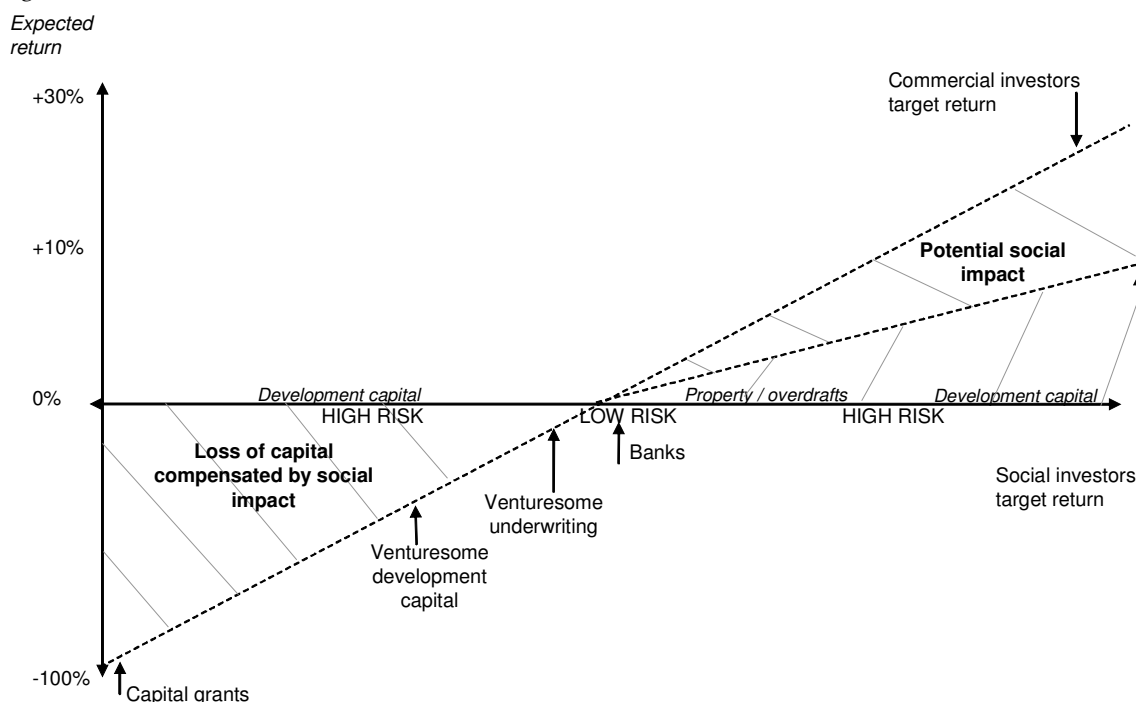
<sup>19</sup> Discussed, with examples, in Venturesome (2008) *Financing Civil Society*.

<sup>20</sup> Venturesome (2008) *Financing Civil Society*. Previous publications have tracked the development of the market year on year.

<sup>21</sup> Social Finance submission to NCVO Funding Commission, available at [www.ncvo-vol.org.uk](http://www.ncvo-vol.org.uk)

can be recycled elsewhere - but may charge below-commercial rates, and overall aim to break even as opposed to generate financial returns. *Figure 2* reflects this idea.

*Figure 2*



*Figure 2* also sketches out how investors weigh up how to price the level of risk. The level of risk is commensurate with the nature of the capital need, but for social investors, pricing will also factor in the expected 'social return' – financial return is traded for social return.

Finally, and linked to the above point, few suppliers have demonstrated a robust and resilient income and expenditure model themselves – aside from those operating at scale at the lower risk end of the spectrum, and even there all is not well. Many are greatly threatened by the current economic climate of low interest rates; most suppliers required subsidy of some kind, and/or made losses, even before the recent downturn.

### Characteristics of robust market: clarity

- Clarity regarding how the three dimensions of risk, financial and social return, and price work together.
- Clarity regarding where donors/investors place themselves on this three dimensional spectrum.
- This requires established asset classes, resulting in a genuine range of mechanisms that meets the financial needs of charities (senior debt through to grant capital).

### Barriers

It is likely that the limited range of mechanisms in use reflects the small size and immaturity of the market. But it also reflects:

- Risk aversion, on both demand and supply sides
- Funder motivation. For example, underwriting is barely used. There seem to be two reasons for this. One, the benefits of underwriting are difficult to articulate. Over 100 underwriting investments have been made by Venturesome, and in close to 90% of cases the funds go undrawn. The impact does not come from drawing the funds, but in having a safety net which enabled the charity to proceed where otherwise it might not have done. But pointing to what might not have happened otherwise does not provide a particularly tangible success story – or, rather, it does not fit the paradigm funder success

story. Two, much supply is under pressure to 'get the money out of the door', as if this were a measure of success. Linked to this are pricing difficulties; how to cover costs of supplying underwriting, if the funds are not drawn, in this low interest rate climate.

- Lack of quality advisers / corporate financiers in the sector. The bulk of strategic and financial advice typically points charities to fundraising (raising grants), the mainstay of the sector.
- Legal structures within the sector limit investment (e.g. equity is not available to charities, asset lock on community interest companies).

Clearly, a variety of investment mechanisms relies on a resilient supply of capital, which can be used in innovative ways. This is covered in the next section.

### Emerging players and ideas

- Venturesome has divided its fund into a series of experimental funds, including:
  - Development Fund, testing connections between providing development capital, the capacity building that enables and ensuing social impact
  - Innovation Fund, testing out new financial mechanisms
  - Standby Fund, scaling low-risk investments (e.g. underwriting), as an offer to philanthropic investors
- Social Finance is developing thinking around a Social Impact Bond, linking investment directly to social outcomes, with investors and investees 'rewards' linked to success in delivering pre-agreed outcomes. See [www.socialfinance.org.uk/downloads/SIB\\_report\\_web.pdf](http://www.socialfinance.org.uk/downloads/SIB_report_web.pdf)
- New Philanthropy Capital (NPC) has historically taken a broad church approach to methods of measuring social impact (all were welcome), but is moving towards generating common tools for use by the sector, and benchmarking. See [www.philanthropycapital.org](http://www.philanthropycapital.org)
- The CIC Regular recently closed its consultation, results pending, on lifting the dividend lock on CICs, which has for some restricted access to capital. Elsewhere, the Charity Commission has been working for some time on a new form of legal structure, the Charitable Incorporated Organisation, partly intended to simplify reporting and regulation. [www.charity-commission.gov.uk/registration/charcio.asp](http://www.charity-commission.gov.uk/registration/charcio.asp)

## 4) Resilient supply of capital

### Current situation: no clear supply of capital

As discussed previously, the bulk of funds available to the sector take contract or grant form; whether via public donations, high net worth giving, trusts and foundations or central or local government. The size of capital supply available to the sector is unclear; it has been estimated at £1 billion but there is no robust evidence to support this figure.

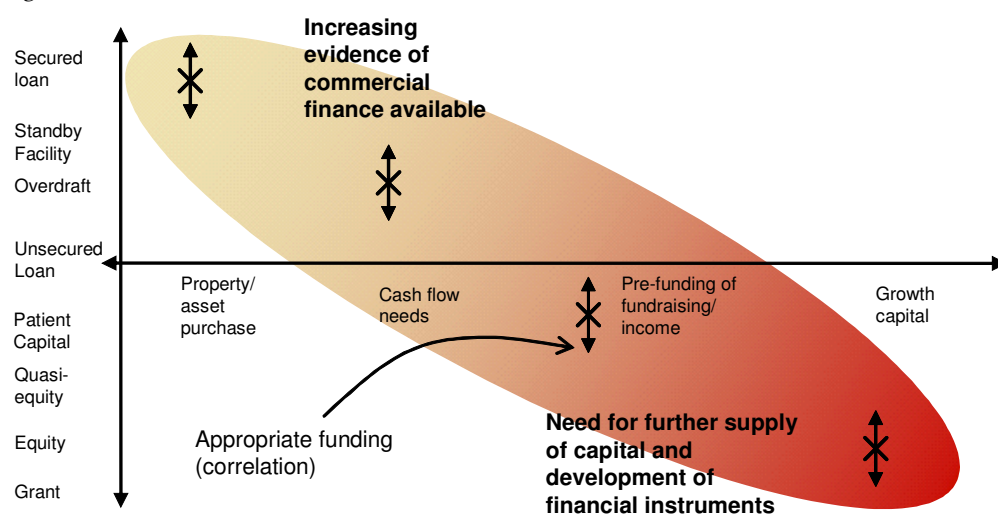
Estimates are hampered by the lack of transparency and lack of agreed definitions. One can observe, however, that supply is dominated by government funds (of which ACF manages the bulk, c£415m<sup>22</sup>). Very few philanthropists are engaged in social investment, indeed there are limited opportunities for them to do so. There are even fewer opportunities for the general public to get involved – aside from putting funds on deposit with specialist banks (e.g. Triodos, Unity Trust Bank, Charity Bank), in order to see funds used to support charities via low-risk financial mechanisms.

There is gathering interest in mission-connected investment (investing endowment funds in social or environmental opportunities, for market return) from foundations, but programme-related investment (investing funds at below market return, to generate social return) is proving a bigger step.

As indicated previously, banks have become more active in this sector over the last ten years or so, largely through the provision of mortgages. Government schemes, such as the Enterprise Finance Guarantee Scheme, are ostensibly open to the sector but subject to the same decision criteria as banks operated previously.<sup>23</sup>

If we look at how the sources of supply, above, are distributed, again the majority of supply is at the low risk (secured lending) end. *Figure 2* indicates the range of mechanisms in use, and for what capital need they are most appropriate – the lightly shaded area indicates where supply is dominant, and the dark shaded area where funds are in shorter supply.

Figure 3<sup>24</sup>



<sup>22</sup> Funds under management include Futurebuilders, Health Social Enterprise Investment Fund and Communitybuilders.

<sup>23</sup> Leading to concerns that the lack of take up/accessibility may be translated (wrongly) as indicating that the sector does not need working capital support.

<sup>24</sup> Adapted from Venturesome (2008) *Financing Civil Society*

Specialist banks are increasingly active (particularly over the last nine months) and strong, but the majority operate at the relatively low risk end of the spectrum. The remainder (most) suppliers are independent, small specialist lenders. Most suppliers are national, although there are a number of local initiatives (for example, Key Fund Yorkshire).

In some ways, the need for access to capital is a symptom of another cause, hinted at earlier in this paper – namely, the revenue funding market. This paper is not the place to discuss this issue<sup>25</sup> but it must be recognised that some capital investment is effectively compensating for poor (income) donor practices.

### **Characteristics of robust market: diverse supply of capital**

- No one dominant source of supply, but a diversity of supply from public, private and individual sources
- As before, a sector in which funders/donors themselves recognise capital needs and understand what type of donor they are (giver, project grant-maker, purchaser, investor) and adapt appropriate tools/ways of working that reflect that intention
- A diversity of supply therefore requires an upskilling of current sources of supply, if they are to adopt capital investment mechanisms themselves, and/or a variety of distribution routes, that are transparent about risk/returns/pricing so that suppliers can select appropriate partners through which to distribute funds
- Referring back to *Figure 2*, a greater supply of capital that is at genuine risk (i.e. source of supply that are able and willing to sustain losses), recognising that for the majority of charities it is not possible to deliver both financial and social returns. Of particular concern is the increasing hype around the potential for commercial investment into the sector (with the ultimate aim of extracting funds from the sector for distribution to private/commercial investors).
- This, of course, requires distributors (social investors, community development finance institutions) that can demonstrate resilient (sustainable) income / expenditure models. Only a handful have demonstrated a resilient income/expenditure model, without recourse to external (grant) subsidy, and that was prior to the current low-interest rate climate which is extremely threatening to many providers.

### **Barriers**

- Not only is the financial climate threatening charities themselves, it threatens the resilience of retail investors and indeed sources of supply. Continuing dominance of government funding in this space is unlikely, while foundation endowments have typically dropped by 20-25%, squeezing income available for distribution. This may offer an opportunity for alternative, recyclable mechanisms – but not if it cannibalises existing sector (income) funding.
- Among potential sources of supply that are socially motivated (foundations, philanthropists), there is some scepticism re. the social benefits of social investment – why social investment is beneficial for the investee/what connection it has to the outcomes delivered by the investee. Specialist lenders have struggled to articulate their role and its value to the sector – more work is needed here.
- There has been no coherent offer to philanthropists as to how to get involved in this area. This may be compounded by the lack of tax incentives; donors receive relief on charitable donations, as do investors in venture capital at the other end of the spectrum, so why are there no tax breaks for those wishing to invest capital for a period of time to finance social investment?
- The charitable world is arguably divided into (financially motivated) investors and (philanthropically motivated) givers – this dichotomy is found within foundations, and within individuals' own behaviour. It is a bigger psychological/cultural leap than might

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<sup>25</sup> See Clara Miller (2005) *The Looking-Glass World of Nonprofit Money: Managing in For-Profits' Shadow* for an excellent overview of the difficulties.

at first appear, to go from giving money away to investing it, not for commercial return, but so that it may be recycled for social impact. Products are required that will entice investors in. The challenge is succinctly put by Sasha Dichter<sup>26</sup> of the Acumen Fund: *'As a sector I think we could get a lot more sophisticated in explaining that there's a big space between a negative 100 percent financial return (for grants) and double digit returns for private equity. We need to define that middle ground if we expect to see significant influxes of new capital.'*

### Emerging players and ideas

The financial crisis has catalysed a number of debates, if not concrete action, around finance and whether it ought to be more socially-minded. A number of ideas and movements are gathering momentum:

- Commission for Unclaimed Assets laid considerable ground for the potential for unclaimed assets to capitalise a social investment bank. The debate has evolved since, culminating in the Cabinet Office's current consultation around the potential role a Social Investment Wholesale Bank might play in supporting access to capital, and the potential sources of supply for such a bank.
- Mission-connected investment is gaining ground in the UK, taking learning from the US. See [www.neweconomics.org/gen/climate\\_ecodebt.aspx](http://www.neweconomics.org/gen/climate_ecodebt.aspx)
- Venturesome and the Esmée Fairbairn Foundation collaborated on a programme-related investment pilot. The Foundation has subsequently launched a Finance Fund. Venturesome is exploring other potential partnerships with a view to unlocking charitable funds for capital investment.
- Citylife bond issues; generating income for charities by unlocking philanthropic capital (from communities of interest) that is then invested in registered social landlords, with the interest distributed to charities: [www.citylifeltd.org](http://www.citylifeltd.org)
- Considerable momentum is gathering behind the concept (and practice) of community share issues, the old idea of public subscription reinvented for current times, spearheaded particularly by the Development Trusts Association and Cooperatives UK. [www.communityshares.org.uk](http://www.communityshares.org.uk)

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<sup>26</sup> Good Capital newsletter Issue 15, *Acumen Fund Puts Its Money Where Its Mouth Is*, Kevin Jones

## Postscript

A number of key questions arose from the roundtable which go beyond the issues identified in this paper. These are included here as additional points to reflect upon:

- **Social investment for whom?** This paper uses ‘charities’ as short-hand for a broad spectrum of organisations identified in *Figure 1*, but this spectrum is biased towards charitable institutions - what of public sector organisations, individuals, or groups of individuals? Do they, equally, require access to capital, and in what forms? Are the barriers the same for these groups? Equally, we should note that access to capital is more of an issue for smaller entities than large, established organisations.
- **Capital from where?** Sections 3 and 4 of the paper touch on the range of supply required, and the potential sensitivities of commercially-motivated investors extracting capital from the sector. How can we ensure that funds flowing to the sector are catalytic, i.e. help develop the sector, as opposed to flowing out as quickly as they flowed in which risks weakening the existing ecology?
- **How do we capture social capital in this debate?** This paper focuses exclusively on financial capital; should social capital (the confidence and capacity built up within social networks) be factored in to the debate? And how?
- **The importance of research** – as Section 1 indicates, evidence of need and demand relies too heavily on anecdote. Research into the understanding and needs of charities themselves in relation to capital is overdue, perhaps particularly in relation to trustees’ perspectives.
- **Who pays for investment readiness support, and how do we ensure its quality?** A mix of parties pay currently; third parties, suppliers of capital themselves and charities themselves. This is linked to the latter point as to who delivers investment readiness and the quality of the work (how do we recruit skilled people into this field?), because whoever funds the work they will only be willing to do so if confident of the quality.
- **The need to develop financial mechanisms that capture *appropriate* social returns.** Building on Section 3, third sector funding (income for day-to-day activities) increasingly specifies desired outcomes as a condition of funding, whether in a formal or informal contract arrangement (particularly with the increase in commissioning and contracting from government). Contract funding is wholly appropriate in certain circumstances, but if all funding took this form there would be little room for innovation. Suppliers of capital ought not to fall into the trap of seeking project outcomes as the indicators of success for their funding; capital investment is *directly* linked to building the capacity of organisations, and *indirectly* linked to the impact on beneficiaries. More work is therefore required on capacity building monitoring and evaluation tools. CAF, via its Advisory programme, has developed work in this area (among others). Venturesome’s Development Fund is applying such capacity building measures to its investments.