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**Centre for Charity
Effectiveness**

Social investment

as a new charity finance tool:

using both head and heart

A practitioner research paper

Mark Salway

Cass Centre for Charity Effectiveness

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Social investment as a new charity finance tool: 'using both head and heart'

A practitioner research paper
Mark Salway

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“Do not go where the path may lead, go instead
where there is no path and leave a trail.”

Ralph Waldo Emerson/Muriel Strode

**Social investment as a new charity finance tool:
‘using both head and heart’**

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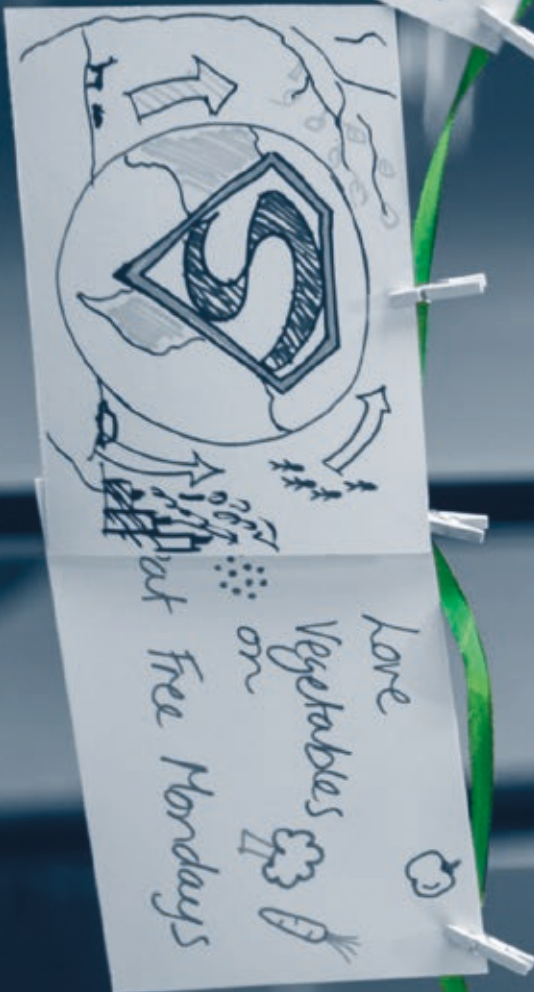
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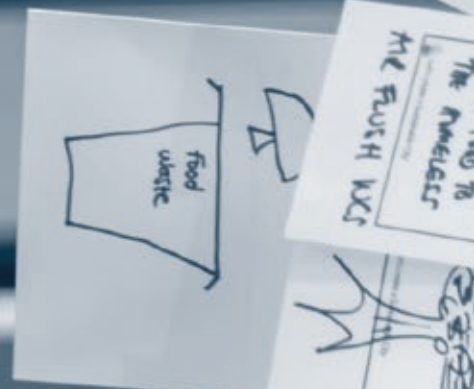
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How can charities maintain sustainability and vibrancy while improving their social impact?



Foreword

Mark Boleat

The City of London Corporation realised some time ago the critical need to find different funding models for social purpose organisations: charities, social enterprises, social businesses and those organisations who provide a safety net for the poorest and most marginalised.

We saw the intense financial pressure on these organisations at the same time as a step-change in demand for their services. As such, we set aside money to build capacity in these organisations as well as a social investment fund to help them grow.

Social investment is the blending of more commercial type ‘investment’ funding to create both a financial as well as a social return on investment. It can help develop sustainability, and enable charities and social enterprises to grow and scale their work effectively, while focusing clearly on the social value they create.

While I believe that grants and donations are also important to build these organisations, I see that social investment will become a more important part of the social funding landscape. It has a different feel about it, and a new energy.

I am excited to be part of this report, as I spoke at the initial symposium which kicked off this work in November 2015. It has taken colleagues from Cass Business School eighteen months to compile data and synthesise this into this report, and take a rigorous look at this from the point of view of charities. This report importantly carries the analysis from a questionnaire, as well as over 150 interviews. A good size sample from which to draw conclusions.

Firstly, it identifies that we must be careful to consider charity finance strategy, and its motivation, before we can understand social investment’s place as a tool within this.

Secondly, we need to understand the issues of head and heart which come together to make this new tool work.

The key finding that charities want new funding models and see social investment as a powerful new tool is encouraging. Sixty per cent of all charities see social investment as either positive or transformatory to them.

Equally the report does not hide the different dimensions that must be considered for it to be a success: from data and impact measurement, to aligning motivation between charity and investor, through to addressing issues with charity trustees who are less positive about this than their management teams.

I am pleased to be part of this important practitioner research, and am sure it will help develop charities and their important work for the future.

Mark Boleat

Chairman, City of London Policy and Resources Committee

Foreword

Dr Noorzaman Rashid

Several years ago the Worshipful Company of Management Consultants placed some seed funding in a new initiative with Cass Business School, Centre for Charity Effectiveness.

The idea was to help charities move away from their dependence on grants and donations, and to help them see social investment as a potential new tool. From that grant, the Centre invested in a consultant, Mark Salway, who quickly determined that lack of understanding was the key issue to charities exploring this.

The Centre for Charity Effectiveness has now run over seventy workshops and conferences to help charities explore this new tool and become more aware of its possibilities. This has helped build capacity with thousands. We were proud to be part of the Symposium as a big conversation bringing key voices together from charities as well as investors and the government to explore this.

The social investment initiative has spread to the Middle East, India, Russia and South America as well as inspired many across Africa. A fledgling consulting and mentoring capacity has been built and this has led to pieces of work with small charities, all the way up to international NGOs and the UN. A wide cohort of MSc students have also been taught about social investment as a new tool. A simple toolkit and 'how to' guide have been developed.

So what is social investment? It's quite easy to get the concept, just much harder to define it. It uses repayable finance and investment to create a social and financial return to help address social issues.

We are excited to be part of this report as it brings together the learning from work to date. It focuses from the charity, rather than from the investor point of view, and as such is one of the first reports to do this.

It brings sharply into focus that charities want this new tool, but don't yet know how to use it clearly.

The report also explores charities' motivation for using social investment and highlights that it can help develop sustainability and predictable income streams – which is what charities want.

As a 'great modern Livery company', the Worshipful Company of Management Consultants is keen to promote this type of research and work.

We are excited to see where the initiative we seeded will go next, but first want charities to learn from this key report and be inspired to understand and explore this for themselves as a potential new tool.

Dr Noorzaman Rashid

Master of the Worshipful Company of Management Consultants

Acknowledgements

Cass CCE has come together with [Big Society Capital](#), [Charities Aid Foundation \(CAF\)](#), [Charity Finance Group \(CFG\)](#) and [Macquarie Bank](#) to explore charity finance and social investment as a big conversation – cutting to the heart of finance strategy.

This report is the culmination of over a year of research and has involved many people to whom I am extremely grateful, specifically my wonderful partner [Ann Hartland](#), and also [Paul Sizeland](#) and [Steve Cant](#), who helped me tremendously to shape my thinking.

We are grateful to those who have very generously supported the development of this report both financially and intellectually:

- [Worshipful Company of Management Consultants](#) and especially [David Peregrine Jones](#), [Patrick Chapman](#) and [John Pulford](#)
- [C. Hoare & Co.](#) and especially [Alexander Hoare](#)
- [Big Society Capital](#) – [Geetha Rabindrakumar](#)
- [Charities Aid Foundation \(CAF\)](#) – [David Stead](#)
- [Charity Finance Group](#) – [Andrew O'Brien](#) and [Caron Bradshaw](#)
- [Macquarie Bank](#) – [Clare McCartney](#) and [Rachel Engel](#)
- [The Robert Brown Memorial Fund](#)
- [Maurizio Bragagni](#)
- [Higher Education Innovation Funding](#).

Those who helped with the research:

- PhD researchers and students ([James Knuckles](#), [Kevin Curran](#) and [James Buckley](#)).
- All those who have talked with me face to face, and attended our symposium and seminars – too many to mention individually but I am grateful to you for sharing your knowledge and experiences.
- I especially thank everyone who took part in the survey for giving us a solid data set to analyse and draw indicative conclusions.

Our design consultants [Text Matters](#).

My colleagues at [Cass CCE](#):

- [Professor Paul Palmer](#)
- [Alex Skailes](#)
- [Caroline Copeman](#)
- [Professor John Hailey](#)
- ... as well as a wide group of people who reviewed this report.

And the editor: [Denise Fellows](#).

[Mark Salway](#) (Cass CCE, London)
May 2017



**Social investment
is a powerful charity funding tool
to help address social issues**

chapter 1:

Executive summary

1.1 Introduction and a definition of social investment

In recent years charities across the UK have seen a significant increase in demand for their services, set against a more difficult fundraising environment for both donations and grants.

Government funding has shifted fundamentally towards payment-by-results contracts and commentators across the sector have started to question how charities can maintain sustainability and vibrancy while improving the level of social impact.

Meanwhile, in the investment market, some investors have expressed profound concerns about solely pursuing financial returns. They are starting to demand that their money generates not only a financial return, but also a social return. Slowly and irrevocably, the landscape of both charity finance and mainstream investment is changing.

Within this environment, the market for social investment is growing. It is an easy concept to grab hold of, but harder to define. Social investment uses ‘commercial style’ investment tools to fund charities and social ventures. The intent is to use any such investment to create both a social *and* a financial return. Charities then pay the capital back, either without interest, such as in a repayable grant arrangement, or with interest to compensate for the investor’s risk.

What do we mean by social investment?

‘Social investments have the intent and motivation of generating a social or environmental impact as well as financial return on investment. They aim to measure both the social and financial value they create and be held accountable for this.’ – [Cass CCE](#)

1.2 Our research

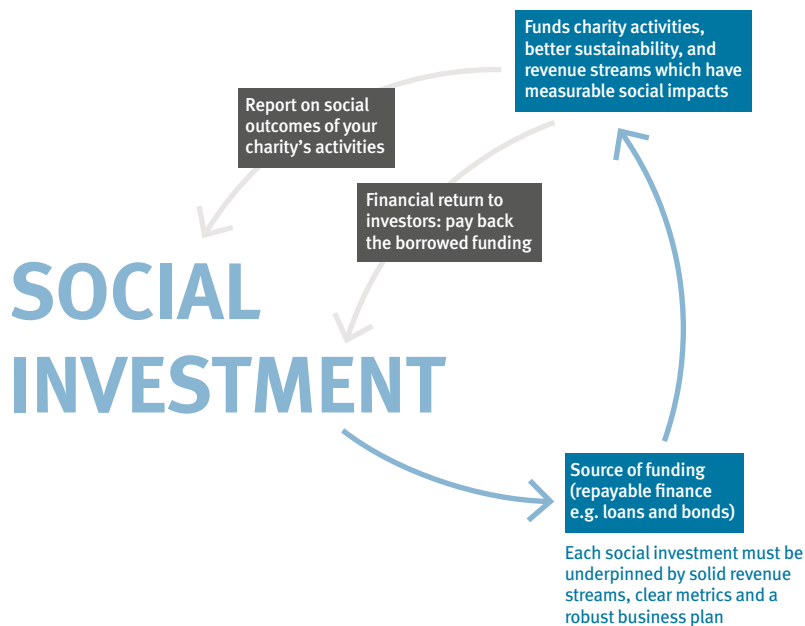
In this report we have looked from a charity-sector perspective to inform those trying to develop and build demand for social investment. This report draws from multiple layers of practical research conducted over 12 months during 2015 and 2016:

- A survey answered by 190 charities, funders and advisors around the trends in charity finance and social investment
- A high-level symposium gathering thoughts and ideas from over 100 senior leaders in social investment
- A series of exploratory seminars on social investment entitled ‘Demystifying the Hype’
- A literature review focused on the environment, barriers and mind-set around social investment
- Over 120 face-to-face interviews.

This report comes to the conclusion that social investment can be a powerful new tool to help address social issues and fund the charity sector, and that charities want this, especially where there is clear alignment of motivation between charity and investor.

To achieve this, charities need to be able to use both ‘head’ and ‘heart’ to overcome traditional reservations about perceived commerciality and to develop robust funding models that will support social impact and the creation of a sector fit for the challenges ahead.

Figure 1: Social investment at a glance



1.3 Strategic need for charity finance

To understand the demand for social investment, the report first considers charity finance strategy and how the sector perceives its current funding models. Our research finds a sector under financial pressure, but equally that most charities feel positive about their ongoing financial strategy and sustainability. This is possibly leading to inertia – a lack of motivation to change or explore new tools and models.

Charities surveyed were quick to see the link between their funding and how it maintains sustainability and impact. However, they were less able to see the link between funding models and growth or innovation. Large charities claimed a good understanding of their funding models, whereas small charities appeared to require help to formulate new business models underpinned by sound financial strategies to help them grow.

Many charities have a mind-set focused first and foremost on sustainability, rather than thinking about impact as the prime focus of a charity's work. We identify that charity trustees often equate stewardship solely with ensuring financial sustainability, rather than focusing on mission and impact.

The growth of social investment relies on building bridges so that money can move from investors to charities. Having historically been funded by grants, donations and contracts, why should charities now change to use more investment-type tools?

Charities surveyed see their funding models as changing and independent of size, sector or objective. They anticipate a major shift in funding models – away from donations and grants and towards social investment and more borrowing in the next five years. The research estimates this shift to be approximately 11 per cent of funding, equivalent to around £4bn–6bn capital for the sector.

In contrast to general trends, the survey indicates that many charities would not borrow for working capital, fundraising or even for property. Equally, many would not borrow to start a new project or programme. Many charities see themselves as needing to evolve towards social investment and borrowing but are unsure how to do this.

1.4 Social investment as a tool

Social investment is *not* a silver bullet to ease all funding issues and it takes time and effort to implement. There is a danger that some charities may embrace it as a panacea for the reduction in grant funding without proper consideration.

Through our research, we have developed a framework of nine components important to consider when using social investment:

1. The business model and funding strategy
2. The culture and mind-set of the organisation, along with ethical considerations behind the investment
3. The measurement of social impact
4. The team, capacity and investment readiness of the charity
5. The intermediaries and funders – SIFIs (Social Investment Finance Intermediaries) and government commissioners
6. Alignment of investment motivation between investor and charity
7. Balancing social return on investment (ROI) vs financial ROI and risk
8. The type of investment
9. Language and terminology.

Our research shows that working together with the investor to understand investment motivation and aligning this effectively with that of the charity is critical to build trust. Banks are not the only investors. Many charities simply do not realise that a wide range of potential investors is now open to them and that each has very different motivations for investing.

“We need to empower trustees to explore different business models and to have a risk appetite for innovation and change”

1.5 Developing the social investment market

The market for social investment continues to build at a rate of 20–30% per annum and has reached around £1.5bn capital, according to the latest figures from Big Society Capital (2016). The average value of individual investments and loans is reducing to meet the demand for smaller loans within the sector.

Our research shows that we are approaching a tipping point where social investment is gaining sufficient momentum and traction to move into the mainstream and away from being seen only as a ‘niche’ product.

As grants and donations shrink, the ready availability of investment monies (estimated at over \$2 trillion) should exert a more pronounced force on the charity world. However, there are concerns that if charities do not start to take up the opportunities, then investors will go elsewhere.

Many charities have ethical and cultural concerns about using investment tools. They are stuck in a grants and donations mind-set and have concerns about how they will pay back capital. The battle between ‘head and heart’ within charities to use more investment type tools, will go hand in hand with the difficult evolution of investment products that provide lower financial returns in exchange for greater social return on investment.

“60 per cent of charities saw social investment as either positively changing their business models or being transformational to them”

Charities want money that is affordable and will help them build sustainability and predictable income streams. Given this, perhaps demand for social investment will grow more strongly where there is alignment with these objectives.

Our survey showed that:

- 60 per cent of charities saw social investment as either positively changing their business models or being transformational to them
- 33 per cent of charities felt that social investment would bring little or no change to their organisations
- 7 per cent were openly negative about it.

Trustees were positive on almost all aspects of charity finance strategy, but were 20 per cent more negative than the CEO or FD on social investment. Addressing trustees’ risk aversion towards social investment will be critical if social investment is to be successful. We also need to empower trustees to explore different business models, and to have a risk appetite for innovation and change.

Where organisations have a social investment champion, this person can help take social investment forward and help others to see the potential. It is highly correlated that those organisations where no champion exists typically do not even consider social investment. Building capacity in charity finance professionals and trustees will be key.

This report comes to a key conclusion that **the main barrier to charities using social investment as a tool is lack of understanding**. Our research shows that if organisations understand social investment, they are more likely to use it and think positively about it (+20%) and if they don’t understand they are less likely to use it and will think negatively (-24%). We need to develop training and mentoring for the sector and especially the capacity of finance professionals, who often focus on finance to the exclusion of impact.

There is huge inquisitiveness and eagerness to learn within the sector. We now need to build the social investment market thoughtfully and purposefully for the future.

chapter 2:

About this report

2.1 Background

Historically charities have relied on four main forms of funding: grants, donations, investment income and, more recently, the rapid growth of government contracts. In the last few years, government grant funding has reduced significantly due to intense pressures on the public purse. There is also a greater level of competition for general donations and government contracts. Within this context, how can the sector evolve to maintain its impact and the scope and scale of its work? Equally, with increasing demand for charities' services, how can the sector grow to meet this demand?

To understand this and the potential need for new funding models, this report first considers charity finance strategy, and how the sector perceives its current funding models. Our research finds a sector under financial pressure, but one where most charities feel positive about their ongoing viability and funding strategies. This is leading to inertia – a lack of motivation to change or explore new tools and models.

Social investment sits within this context as a potential new charity finance tool. It is an easy concept to grab hold of, but harder to define. It uses 'commercial style' investment products to fund charities. The key aspect of social investment is that it enables charities to borrow money (through loans, bonds or other repayable finance) with the intent of creating both a social *and* a financial return.

It is not enough for money to be put into the reserves for general use. For social investment to be categorised as such, a charity must measure the impact of its use and aim to report transparently against this. The charity will then pay the capital back, either without interest (such as in a repayable grant arrangement) or with interest to compensate for the investor's risk. **Each social investment must be underpinned by solid revenue streams, clear metrics and a robust business plan.**

Our research shows that many charities do want social investment and see their financial models moving away from grants, donations and contracts in the next five years and towards a more balanced mix of funding streams, including social investment.

We are also seeing the birth of a new kind of funder, one who wants to be philanthropic but also seen as a social investor rather than a giver. This opens up opportunities for charities that can align the motivations of investors with their causes.

Aims of this report

- To help the reader understand the need to think strategically about finance in charities
- To better understand social investment as a new tool to help charities become more sustainable, evolve and grow
- To help close the gap between the supply of social investment monies and the demand.

Charities may feel conflicted or uneasy about using borrowing or investment tools. They may also have ethical concerns. Social investment is not suitable for all charities and is not a silver bullet. We conclude that the main barrier to charities using social investment as a tool is lack of understanding.

Social investment does not have to be complicated, but the social investment community has often made it so. The volume of press coverage focused on social impact bonds, for example, may have caused confusion. In reality, small-value loans are one of the most powerful investment tools to help charities grow and leverage their funding. A mix of grants, donations and social investment funding is seen as the future for many.

This report has been developed following a symposium in November 2015 held by the Centre for Charity Effectiveness at Cass Business School with Big Society Capital, Charities Aid Foundation (CAF), Charity Finance Group and Macquarie Bank. Over 100 voices from the sector came together to discuss charity finance and social investment as a tool. The symposium drew on the findings from the survey answered by 190 charities, funders and their advisors and a review of the literature on social investment. The findings have been further substantiated by face-to-face interviews and a series of seminars entitled 'Demystifying the hype'.

2.2 How this report is constructed

This report builds on the findings of our practitioner research and aims to inform those trying to develop and build demand for social investment, as well as practitioners wanting to understand and use it in their own organisations.

Through the report we follow the journey you need to take to develop an understanding of social investment and the need for it, and to implement it and build the market:

- **Chapter three** starts with a discussion about the strategic need for charity finance and explores why this is important when considering social investment. The chapter looks at current sector funding and recent trends and analyses from our survey results focused on charity finance.
- **Chapter four** provides an overview of social investment as a tool. It discusses what social investment is, the motivators to use it and the component parts you need to implement it.
- **Chapter five** discusses how to engage charities with social investment. It looks at supply and demand of capital and examines our survey results focused on social investment.

At the end of each chapter we provide a summary, conclusions and recommendations to help charities further explore this new arena.

Finally, **Chapter six** pulls all of the recommendations together in one place, with next steps and actions.

Figure 2 shows how the different sections of the report build on each other.

Figure 2: The different sections of this report

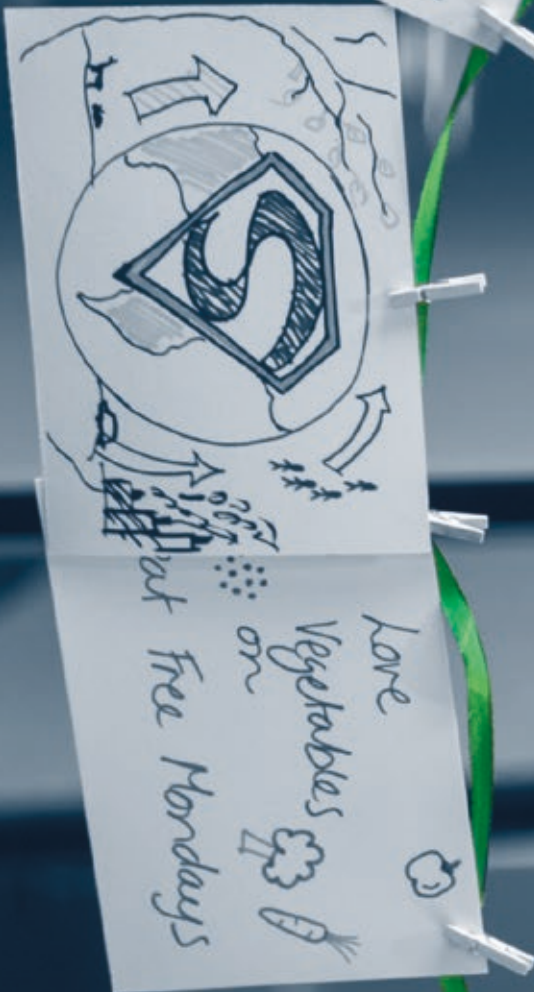


You may want to read each chapter, the conclusions at the end of each chapter, or just the executive summary. We urge the inquisitive reader to dip in and out of the report. Each time you may find something new given the breadth and complexity of the subject at hand.

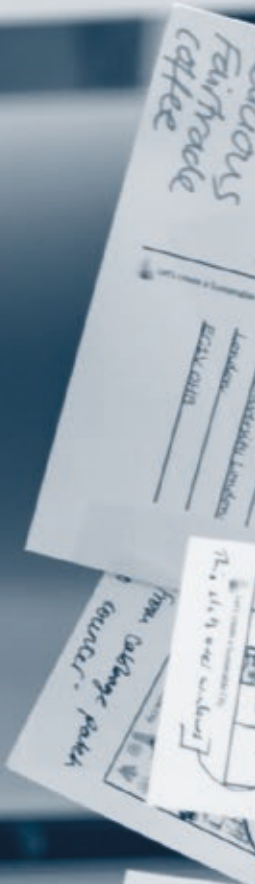
[Appendix A](#) has signposting to reference materials and websites that may prove useful for further exploration. [Appendix B](#) has a more detailed breakdown of the results from the survey, and [Appendix C](#) has information about the research methodology.

We hope you enjoy reading this report and that it stimulates your charity to think about how it funds itself for the future.

Could social investment be a powerful new tool for your organisation and a part of its future funding mix?



Charities need stable and predictable income streams for long-term financial sustainability



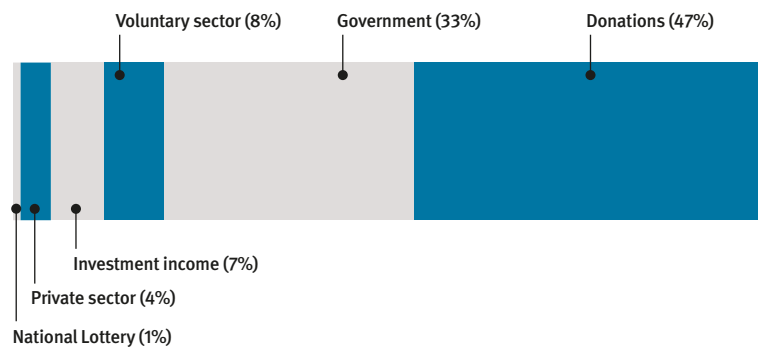
chapter 3:

Charity finance strategy

3.1 Charity finances in overview

The breakdown of funding to the charity sector (NCVO Almanac, 2015b) shows that donations and government funding together make up around 80 per cent of all funding to the sector ([Figure 3](#)).

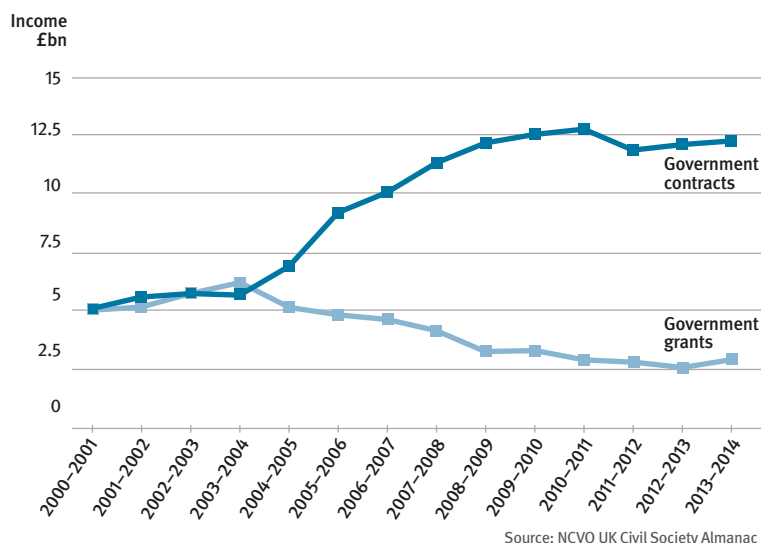
Figure 3: Breakdown of charity funding



Looking first at [donations](#), figures from the UK Giving Survey (CAF 2014a, p. 10) show that donations, adjusted for inflation, fell between 2010 and 2014 from £13 billion to £10.6 billion, a drop-off of around 18 per cent in real terms. Further substantial falls are expected because of recent bad publicity around fundraising and the increasingly poor image this has created in the public's mind.

Looking at [government funding](#), NCVO, in their Financial Stability Review (2015a, p. 11), highlights that in real terms the sector's income from government in 2012/13 was £1.9 billion less than the peak seen in 2009/10, 'causing serious financial difficulties for organisations that depend on government funding'. During this time the move from government grants to contracts has been profound ([Figure 4](#)).

Figure 4: Government funding has moved away from grants to contracts



Charities have needed to learn how to manage payment-by-results contracts and this has changed the nature of how some charities operate and fund themselves.

“The charity sector is under pressure, both financially and in terms of increased demand for services”

The fight for funding is becoming harder. Demand for the sector's products and services is also growing as austerity and cut-backs bite. NCVO (2015a, p. 6) highlights: ‘projections point to a £4.6bn annual shortfall in sector income over the next five years simply to maintain current spending power.’ Given the overall income of the sector is £43.2bn, this drop is significant.

To add to this picture, overheads are under intense pressure and scrutiny. Most notably Bridgespan Partners (2009) warned of a starvation cycle where charities' infrastructure is poorly funded and as a result nonprofit activities cannot be scaled effectively.

PwC (2012) identify that as a result of this funding pressure, 45 per cent of charities are cutting back on services and drawing down on their reserves to fund their work, which inevitably is met from unrestricted reserves. Our interviews and symposium discussions for this report corroborate that picture.

In summary, the charity sector is under pressure, both financially and in terms of increased demand for services.

Chapman and Robinson's report *On the money* (2013) encourages a more positive outlook for the sector, arguing that ‘there is considerably more stability in sector income than might be imagined and that organisations are generally quite adaptable and resilient when faced with change’. This leads us to the conclusion that money alone is not a good indicator of the charity sector's work.

The NCVO financial sustainability review (2015a), finds that charities have adopted a ‘number of coping strategies to deal with the new funding environment’. So, given this ongoing challenge and financial pressure, how will the charity sector maintain its impact and funding for its work?

“Sustainability is based on whether or not organisations can predict their income. If they cannot, then they rank themselves significantly lower in terms of sustainability than those with predictable income streams”

3.2 Overview of our survey results on charity finance

This section summarises the findings from the first theme within our survey, which asked for responses concerning the strategic role of finance in a charity. [Appendix B](#) contains the detail of the results.

General

Our research and survey results identify that charity finance is important as it is a key building block upon which all charity work is built. Finance strategy ensures a common purpose, where operational strategy and finances are aligned, and ensures everyone is pulling in the same direction. It also:

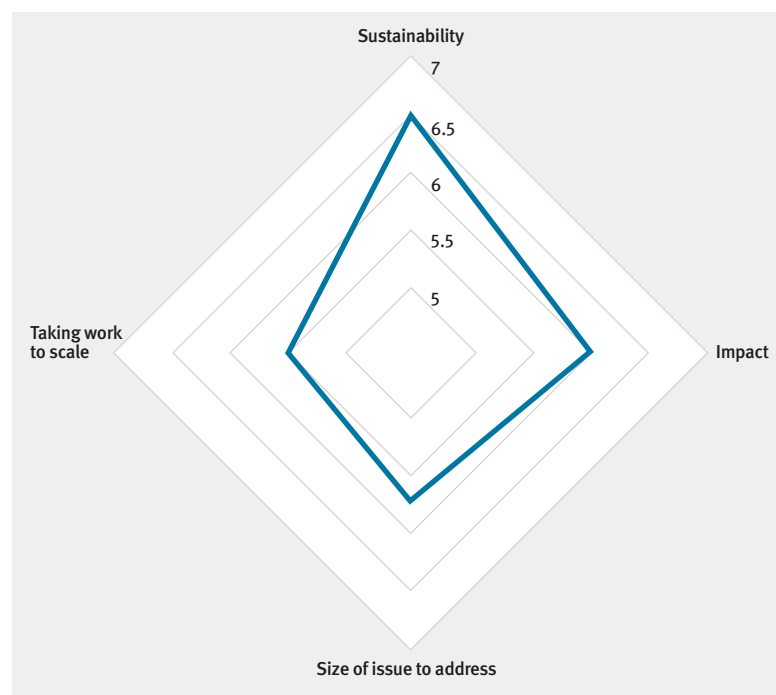
- delivers **sustainability**, ensuring that charities are vibrant and properly funded because their work is important
- delivers **impact**, identifying priorities and delivering funding (both restricted and unrestricted) to bring about social change
- meets **‘need’**, ensuring that charities and nonprofits get the funding they deserve, and that charity work is meeting the profound need that exists
- enables **scaling up** and growth, therefore facilitating greater impact.

What do charities think about when setting their financial strategy?

We used the preceding list to ask charities what they think about when setting their financial strategy.

Our research shows that while 59 per cent of charities consider sustainability when setting their finance strategy, and a similar number (57%) consider impact, fewer than half think about the more complex factors related to their business models, such as the size of the issue they are addressing and growth ([Figure 5](#)).

Figure 5: What charities think about when setting their financial strategy



Scale 1–10 (1 = Don't think about this, 10 = Think about this in detail)

These results led us to question whether charities are primarily focused on sustainability or impact during their strategic planning. Which drives which, or are the two independent of each other?

Our research clearly shows that when charities feel confident about their sustainability, they then think about other things such as impact, innovation and taking their work to scale. When charities doubt their sustainability, they are significantly less likely to focus on any other strategic aims.

On the other hand, when a charity is confident about impact, this has little bearing on how confident it feels about its sustainability and other aspects of its work – positive or negative. There is almost no correlation between impact and other strategic aims.

Our research shows that charities have a mind-set that is focused on sustainability first and foremost when thinking about their finances. Many smaller charities are focused on survival.

Our results also show that sustainability is based on whether or not organisations can *predict* their income. If they cannot, then they rank themselves significantly lower in terms of sustainability than those with predictable income streams. **This is a critical finding and shows that organisations need stability of income streams to have long-term financial sustainability.**

“Respondents indicated that being over-reliant on grants and contracts was their main funding concern”

Narrative responses highlight that those organisations with good planning, diversified income streams, large reserves and a good commercial model are the most stable. Equally, respondents indicated that being over-reliant on grants and contracts was their main funding concern.

What is the pervasive mind-set amongst trustees and finance directors?

The overall picture from our survey highlights that trustees and senior management are focused mainly on sustainability. From our interviews it is clear that many trustees, in particular, have equated their stewardship requirements with financial sustainability alone; it is enough in many trustees’ minds that a charity survives to the next trustee’s watch. This focus takes organisations away from looking critically at impact and creates a potential risk for the sector as a whole.

Secondly, our survey shows that finance directors (FDs) think significantly less about impact when setting financial strategy compared to the board and CEO. FDs will need help to move them away from their primarily financial focus towards seeing organisations holistically with both financial and impact components.

Confidence, reserves, and how organisations are funded

Respondents to the survey were mainly confident about their long-term financial strategy and stability. Most respondents also felt their reserve policy was appropriate.

Given the pressure on charity finances, it would be reasonable to suggest that respondents might not feel very confident in their long-term financial strategy. It is surprising, therefore, that our analysis reveals the opposite. This contradiction will be critical when thinking about a move towards social investment as it suggests that charities lack the impetus to change.

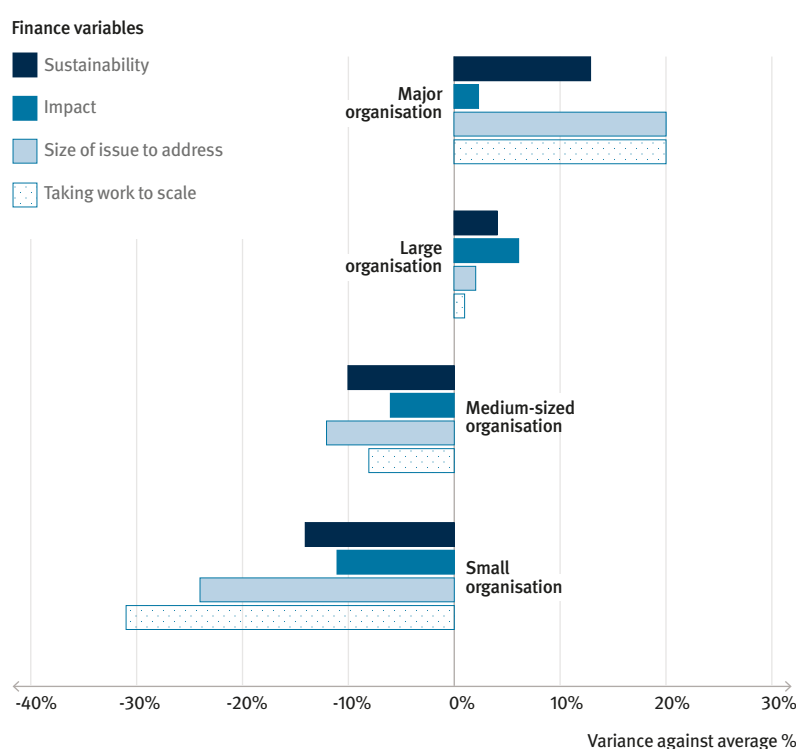
This confidence in the long-term also supports the view that the nonprofit sector as a whole is perhaps considerably more stable and resilient than might be imagined. Equally, it may show that some charities should be concerned about the future but are not recognising the change in their funding. As a result they may be complacent when they should be exploring new models.

Those charities funded mainly from social enterprise (trading business focused on social as well as financial returns) were most positive about their financial sustainability, while those funded predominantly from grants were least positive. Most charities felt that their reserves policy was appropriate, but around 23 per cent felt their reserves policy was too safe.

The size of organisations

The picture was highly correlated to the size of the organisation. Larger organisations felt significantly more positive than small and medium-sized organisations (Figure 6). The survey results clearly show that small organisations will need capacity building to enable them to develop funding models that can provide future sustainability.

Figure 6: Positivity of different-sized charities about aspects of their finance strategy

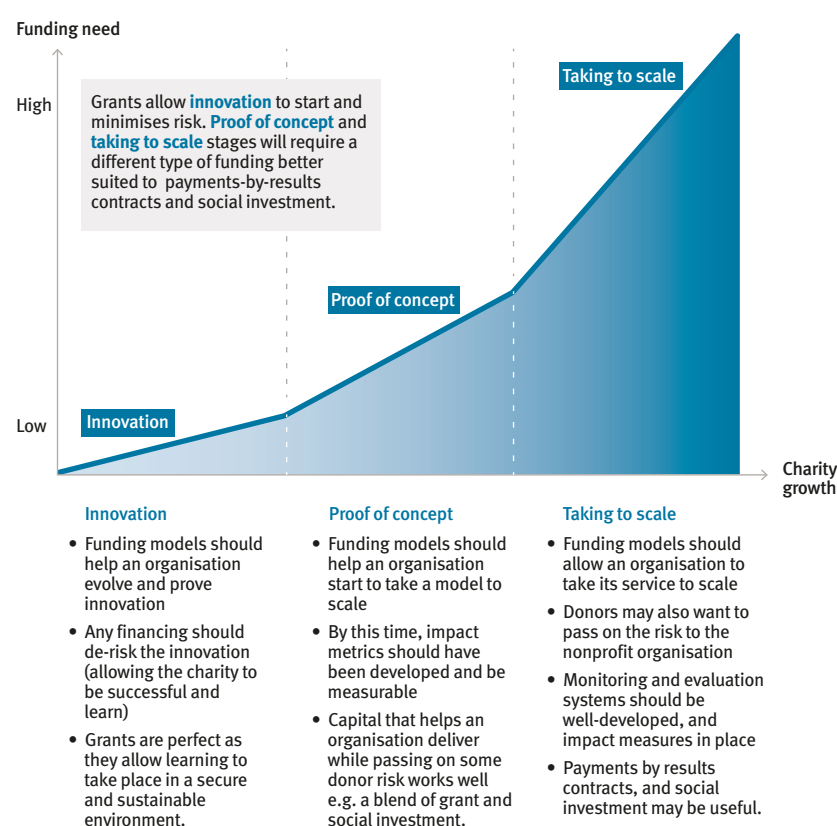


Different funding models as charities grow

Funding needs to be structured around a charity's objectives. Our research highlights that charities don't tend to think about the growth cycle of their work and the type of funding needed to bring this to life. A charity should focus on its strategy for 'innovation' or 'taking-to-scale' or a mix of both, and what is clear is that the funding model should fit those strategic objectives.

Different funding mechanisms are more applicable at different points of a charity's growth (Figure 7). Where a charity has an 'innovation' focus it needs a funding model to provide stability – such as a grant. At the other end of a charity's growth trajectory, when an organisation has a focus on scale, then social investment could be far more appropriate, allowing for more risk sharing, replication and growth.

Figure 7: Different funding models are needed at different stages of a charity's evolution



Charities need to think about their growth cycles and how finance can underpin growth by using the right tools at the right time to support their ambition. They should be able to see their strategic development and potential growth through their funding models.

Charities often understand technically *how* to use different sources of finance, but not strategically *why* to use each source – for example for growth, impact or innovation. This clarity of focus and understanding is critical when we start thinking about social investment later in this report.

Those hoping to build the social investment market will need to help charities develop strategic finance models and specifically demonstrate how charities can align funding with their objectives.

“Funding needs to be structured around a charity’s objectives ... Different funding mechanisms are more applicable at different points of a charity’s growth”

Borrowing as part of financial strategy

From our research we have identified that charities have five main reasons to borrow money as follows:

1. **Cashflow** – Borrowing to maintain cashflow is often a necessary part of doing business, especially where funding is received in arrears. It typically takes the form of a secured loan against assets, but could be unsecured (loan or overdraft) against activities.
2. **Asset purchase** – Investment could be used to purchase a building, property or purpose-built facility that meets a charity’s needs.
3. **Fundraising** – Some charities are starting to borrow and invest against fundraising, which in turn allows them to raise more income and have greater impact and generate sufficient cash to repay the loan at the end of the term.
4. **Funding a specific project or service** – Investment could allow a charity to develop a social enterprise or social venture that could generate income. This might link either directly or indirectly to a charity’s objectives. For example, a coffee shop in a library could simply generate revenue or could also give a homeless person a job.
5. **Change in business model** – investing in IT, for example, could revolutionise services and efficiency. Alternatively, investing in managing contracts could open up new revenue streams.

Recent figures from Big Society Capital put the social investment market at around £1.5bn in the UK (Big Society Capital, Social investment insight series, 2016a). However, the latest NCVO civil society almanac reports that in 2012/13 the voluntary sector owed around £3.5 billion in loans (NCVO 2015b).

Borrowing is different from social investment, as it does not have intent to create both social and financial return on investment, and is typically used for general funds.

Given the existing demand for borrowing in the sector, we explore what charities further want from social investment in [section 4.2](#).

3.3 Summary

- The funding environment is changing and there is significant pressure on funding streams (grants, donations and contracts) as well as intense competition for funding. Despite this, the charities we interviewed and surveyed feel confident in their financial strategy and most feel they have appropriate reserves policies. This perhaps accounts for some of the reluctance to change their funding models towards social investment.

“Charities feel positive about their ongoing funding strategies and reserves policy. This is leading to inertia – a lack of motivation to change or explore new tools and models”

- Charities often see the link between their financial strategy, sustainability and impact. However they often don’t consider how they will take their work to scale, or the size of the problem they are trying to solve. Charities are poor at considering their growth cycle and how funding can underpin this to achieve growth. Delving deeper into this identifies that many charities have a mind-set focused on sustainability. They want predictable income streams and without this they are extremely negative about their financial resilience.
- Small charities in particular need help developing their financial strategies, resilience and capacities.
- Our work identifies that charity trustees often equate stewardship with ensuring financial sustainability alone, rather than focusing on mission and impact. We need to empower trustees to explore different business models and to develop a risk appetite for innovation, of course ensuring appropriate mitigations are understood. Innovation may lead to a higher degree of failure and so it may be appropriate for those charities focused on social investment to explore different models of governance.
- 23 per cent of charities surveyed felt that their reserves policies were too safe. This potentially gives an opportunity to use capital to deliver greater social change or innovate in these organisations.
- Finance directors are focused predominantly on finance; they are significantly less likely to think about impact than other senior managers or trustees. Finance directors will need to be trained to see that charity funding also underpins impact. Making this link to an impact mind-set is critical for change to happen.
- We note the reasons why charities may borrow as part of their finance strategy: cashflow, to purchase an asset, to leverage reserves for fundraising, to start a new business or social enterprise, and to potentially change their business model (around IT or the move to green technology, for example). We also note the considerable volume of borrowing in the sector already, aside from social investment.

3.4 Conclusions and recommendations: the strategic need for charity finance

FINDINGS	CONCLUSIONS & RECOMMENDATIONS
Funding environment ■ The funding environment for charities is changing. ■ There is pressure on voluntary (fundraising and donations) income. ■ Government income down £1.9bn in last three years. ■ Movement away from grants and towards contracts. ■ Pressure on overhead recovery. Motivation behind charity finance ■ Charities focused on sustainability first and foremost. ■ Charities also focused on impact, but less on how to scale their work, or the size of issues they are trying to address. ■ Without predictable income streams charities won't think about other reasons to use charity finance. ■ Given some charities lack sustainable business models with predictable income streams, they become focused on chasing funding. Business models ■ Charities don't fully and consciously understand their funding models and are stuck in a mind-set of grants and donations. ■ Charities need to diversify income streams given issues with existing funding streams. ■ Charities need to understand the strategic use of their finance models and what type of funding to use at what time in their business cycles. ■ Charities funded by Social Enterprise feel they are more sustainable than those funded by grants and donations.	Conclusions ■ The world of charity finance is changing. From an income perspective, the charity sector is under pressure. ■ There is a need for greater understanding of funding models and the strategic use of charity finance, especially how charity finance can facilitate greater impact and enable the sector's work to be taken to scale. ■ We need to help charities to understand their mind-set focused on sustainability and predictability of income streams and how to explore and create new funding models. Recommendations The sector needs to invest in training and capacity building specifically focused on: ■ how to create sustainable business models ■ how to change existing business models ■ the strategic need for charity finance ■ how to build funding models enabling work to be taken to scale.
Size of charities ■ Small charities are less likely to think strategically and are focused on sustainability to a greater extent than others.	Recommendations ■ Specific training and mentoring for small and medium charities is needed.
Finance directors ■ Charity finance directors are less likely to think about impact of work than trustees and CEOs.	Recommendations ■ Finance directors need specific training focused on how finance links to generating impact.
Trustees ■ Trustees equate the stewardship of the charity with sustainability alone. ■ Need to ensure they focus on mission and impact, as well as sustainability.	Recommendations ■ Trustees need broad training on developing impact and sustainable business models.



**Social investments measure,
and are accountable for,
both the social and the financial value
they create**

chapter 4:

Social investment as a tool

4.1 What is social investment?

The term social investment has only relatively recently entered the mainstream language of charity finance. In recent years there has been a mixture of terms used to define funding of this type, such as ‘impact investment’ and ‘social impact investment’. Behind these words are a wide range of definitions and concepts. Floyd et al. (2015) highlight that differing interpretations of terms are at least partly responsible for ‘problems in the effectiveness and growth of the social investment market today.’

The key thing is that charities borrow money to create a social *and* financial return. They then pay the capital back, either without interest, such as in a repayable grant arrangement, or with interest to compensate for the investor’s risk.

In a large number of cases, social investment has been linked to new social enterprise activities and trading. In other cases, such as funding for contract readiness, this has allowed charities to build their infrastructure. Here, social investment has been used to improve financial management and impact monitoring, for example, which has in turn allowed charities to apply for payment-by-results contracts. Alternatively, social investment has been used to leverage fundraising or buy a new property.

However, one thing is clear. Social investment is not a silver bullet for funding issues and may not be appropriate for every organisation.

Other academic research, especially the 2016 report by Nicholls and Dagers (The landscape of social impact investment research: trends and opportunities), highlights that there are various definitions for social investment, and that these are changing over time as this new field emerges.

Our definition of social investment

We use the following definition in this report: *‘Social investments have the intent and motivation of generating a social or environmental impact as well as financial return on investment. They aim to measure both the social AND financial value they create and be held accountable for this.’*

Our focus on ‘and’ is important as most definitions of social investment are written from an investor’s perspective.

- Previously charities focused on the social impact they created, but now must also think about financial return.
- Previously investment focused on the financial return created, but now must also think about the social return on investment.

These are profound mind-set changes that must be made if social investment is to work.

Types of investment

Social investment takes in a wide range of investments and financing, from loans, mortgages, bonds and simple borrowing, through to peer-to-peer lending and social impact bonds.

Social investment does not apply just to charities and is being used by social enterprises, as well as other nonprofit organisations and ‘profit with purpose’ commercial organisations such as B Corps (these are commercial organisations that write a social mission into their legal constitution and aim to be held accountable to this through a social audit). It is also clear that social investment is breaking down the legal barriers between charities, social enterprises and commercial organisations. Investors are becoming less hung-up on the legal form of the organisation they are investing in and are instead becoming more focused on the social return on capital generated.

Social investment is defined by the *intentionality* of generating a social *as well as* a financial return on investment from carrying out the activity for which the investment is used. Measurement is therefore a key component of a social investment, as is being held accountable and transparent and reporting openly on this. Each social investment must be underpinned by a solid revenue stream, clear metrics and a robust business plan.

There are a wide range and diversity of social investments.

Sources of social investment funding include:

- **Commercial bank loans or loans from charity banks**, e.g. CAF or Unity Bank – typically term loans, they can be secured against property/assets or unsecured.
- **Charity bonds** – typically pay back capital and provide a regular payment of interest (‘Coupon’). Often can be traded. (See organisations such as Investing for Good, Allia and Social Finance.)
- **Foundations and family offices** making social investments to charities, e.g. Esmeé Fairbairn, Impetus-PEF and the Tudor Trust.
- **Corporate organisations** making social investments into charities, e.g. Unilever, GSK.
- **Community investing**, where the local community issues bonds or loans to each other, e.g. CDFIs (community development finance institutions).
- **Crowd-funding** using an online platform to collect and distribute loan funds, e.g. Kickstarter.
- **High net worth individuals and ‘Angels’** who are prepared to lend funds as investment capital, e.g. ClearlySo.
- **Microfinance** – lending small amounts of capital to nonprofits and individuals, e.g. www.lendwithcare.org
- **Social impact bonds** – outcomes-based contracts between an ultimate funder, who will pay for a certain level of delivery at a certain price, a nonprofit and a third party investor. The third party investor initially pays for the intervention, and puts up risk capital in return for a repayment of their capital plus interest and a risk premium, if targets are met, otherwise they lose their money. E.g. GLA Rough Sleepers bond.
- **Ethical institutional funds**, e.g. Rathbones.
- **Trustee loans and existing donors** who may be able to provide social capital to develop social investment initiatives.

See NCVO’s KnowHow NonProfit for more details:

<https://knowhownonprofit.org/funding/social-investment-1>

4.2 What do charities actually want from social investment?

Social investment in context

During 2015–16 we ran six seminars at Cass Business School; 150 charities took part, alongside around 20 investment organisations. The sessions were called ‘Demystifying the hype’ and the aim was to build understanding amongst nonprofits and charities about social investment.

We were also able to understand more clearly the motivations for charities potentially using social investment. This knowledge identified that social investment should be seen for what it is, a tool to help the sector, not a panacea for all.

“Sustainability came out very strongly as the main reason that charities are interested in social investment as a new tool to help their funding”

The seminars identified the primary reasons why charities are interested in social investment as:

- **Sustainability**, ensuring the ability to diversify income streams in a way that is self-sustaining and predictable
- **Impact**, allowing charities to identify priorities and provide funding linked to these
- **Scaling up and growth**, enabling work to be taken to scale and facilitating greater impact
- **Investing in IT or the low carbon economy** and investing in changing business models to achieve this
- **Autonomy and flexibility in income streams**, rather than needing to dance to the donor’s tune
- **Building their internal infrastructure** to focus on impact measurement.

Sustainability came out very strongly as the main reason that charities are interested in social investment as a new tool to help their funding. This aligns well with our findings from [chapter 3](#) that charities think predominantly about sustainability when setting their strategic finance goals.

Our seminar series again highlighted that charities need help understanding social investment and how it can be used, especially help to develop business models that can pay back the investment. This help and support is especially needed by small charities and trustees.

Comparing research on social enterprises

Social investment is a relatively new tool for the charity sector, but we can compare knowledge from a similar sector, social enterprise. Social enterprises aim to create measurable and demonstrable impact from trading and regularly use investment tools to achieve this.

In May 2003 the Bank of England published *The financing of social enterprise: a special report*. In it, they consider the supply and demand of external finance for social enterprises in the UK based on a survey of 200

organisations. From their research they concluded ‘demand for debt finance is limited both by availability of other, cheaper forms of funding, such as grants from charitable foundations and government and by risk aversion’. Despite this research now being over a decade old, these findings are arguably still highly relevant to the development of the social investment market today and to the charity sector.

In Social Enterprise UK’s (SEUK) 2011 report *Fight back Britain*, the following key finding was presented: ‘the single largest barrier to the sustainability of social enterprises is access to finance, with 44 per cent of respondents saying that they are still hampered by the availability and affordability of finance.’

“There are organisations that are not investment ready but will borrow, and equally there are organisations who may have a need for investment and borrowing but perceive the barriers to be too high”

Lyon and Baldock (2014)

Another report by Lyon and Baldock (2014) draws on SEUK’s 2013 survey to investigate this further. They discovered that only ‘15 per cent of the social enterprises were seeking some form of repayable finance, with two thirds of those approaching commercial banks’ and a fifth seeking debt finance from social investors. However, 64 per cent of those surveyed stated they were not interested in debt finance. Lyon and Baldock suggest that those not interested in debt finance are likely ‘not looking to grow, do not have an income generation business model that allows them to have a surplus for paying off loans or are able to identify other non-loan forms of finance such as grants’. They suggest that there are organisations that are not investment ready but will borrow, and equally there are organisations who may have a need for investment and borrowing but perceive the barriers to be too high.

Recent research from the charity sector

In February 2015, Tony Chapman of Durham University published *How willing are third sector organisations to borrow money?* Based on three surveys, encompassing 2,250 nonprofit organisations, Chapman argues that the results presented in the study ‘provide a much more reliable indication of the likely levels of tangible or actual demand for borrowing money’.

Acknowledging that existing research had tended to focus specifically on social investment, Chapman decided to consider the demand for borrowing more generally. He identified that only 14 per cent of respondents indicated that borrowing money was of at least some importance to their organisation and in the past two years 4 per cent had actually borrowed money. In comparison, ‘grants are regarded as being of some importance to 87 per cent of organisations’. This demonstrates a clear sector-wide dependency on grants as a predominant and major source of income.

Exploring the demand for borrowing in more detail, Chapman discovered that, amongst the many factors that nonprofits consider when seeking loans, interest rates were deemed the most significant: ‘80 per cent of third sector organisations (TSOs) state that interest rates are very important when

considering loans’ whereas ‘47 per cent of TSOs consider the ethics of a lender as being very important and 44 per cent say that the relationship they have with their lender is very important’. This finding demonstrates that, by a significant margin, the cost of borrowing is deemed the most important factor when borrowing is considered by charities.

CAF Venturesome, the social investment arm of Charities Aid Foundation, commissioned research in 2014 with the aim of improving the understanding of demand among charities for social investment and repayable finance more broadly. The report, *In demand: the changing need for repayable finance in the charity sector*, differed from previous research in that it focused specifically on registered charities, acknowledging that ‘the charity sector is facing greater demand for its services, more competition for statutory funding and increasing effort required to secure public donations’ and showed that 71 per cent of organisations saw social investment as appropriate. It emphasised the need for charities to consider their business models carefully before moving towards social investment. A charity will need to revisit its activities and finance strategy to ensure that it can pay back what it has borrowed.

The research was undertaken through an online survey of 252 UK registered charities. The report found that 61 per cent of charities ‘have no experience of taking out repayable finance and no expectation of doing so in the future’. Asked how much charities would like to borrow in the future, the majority of charities provided a figure of less than £250,000, with over a third of charities stating an amount less than £50,000. As a result of these findings, CAF Venturesome concluded ‘more needs to be done to increase the provision of affordable risk capital, available at lower amounts.’

“By a significant margin, the cost of borrowing is deemed the most important factor when borrowing is considered by charities”

From the research, it appears that charities want money that is considered *affordable* if social investment is to be successful and the cost of borrowing is a key factor in the success of the social investment market and its growth. Charities are also worried about a potential future increase in interest rates for any borrowing.

4.3 What are the different dimensions of social investment?

Our working definition of social investment was identified in [section 4.1](#).

Social investment sees the coming together of the charity (as the demand-side of social investment) and the investor (as the supply-side of social investment) in a way that intends to deliver both a financial return and a social impact.

Our research findings highlight a framework around which social investment hangs, comprising nine components that need to be explored before social investment can be successfully implemented ([Figure 8](#)). It also matches the

different aspects of the conversations many funders have with charities when helping them think about social investment.

The nine dimensions of social investment divide clearly between supply-side and demand-side considerations, with language and terminology straddling the two.

Figure 8: Nine dimensions of social investment



Mainly demand-side components

- **Dimension 1: The business model and funding strategy** of how a charity will use social investment and how the model will repay the capital while generating both a financial and a social return on investment.
- **Dimension 2: The culture, mind-set and ethical considerations behind the investment** and whether charities feel comfortable or conflicted by using social investment. Also their motivation for its use: sustainability, growth or impact.
- **Dimension 3: The measurement of social impact** and outcomes flowing from the investment.
- **Dimension 4: The team, capacity and investment readiness of the charity**, identifying that skill sets and capacities different to those generally found in charities are needed to successfully implement social investment. An investor will look at both the management team and the trustees, and their skills and commitment to making this a success, before investing.

Mainly supply-side components

- **Dimension 5: SIFIs (social investment finance intermediaries) and government commissioners.** Charities will increasingly receive social investments funds from intermediaries or commissioners of government services (looking towards greater outcomes-focused, value-for-money investments).
- **Dimension 6: Investment alignment** and specifically whether the motivations of investor and investee are aligned. Is the motivation of the social investor primarily mission focused (they may give up some return for greater social impact) or finance first (an investor will primarily focus on the financial return) or focused on a specific theme (e.g. health or education)?
- **Dimension 7: Balancing social ROI vs financial ROI and risk** and how an investor will set a relevant rate of interest, versus the risk and perceived financial and social return on investment.
- **Dimension 8: The type of investment** which best fits the charity and what it is trying to achieve – from simple loans and debt to social impact bonds.

Common issues

- **Dimension 9: Language and terminology** and the considerable confusion around the term ‘social investment’ and what this means to both investor and investee.

Dimension 1: Developing business models and appropriate funding strategies for social investment

Business models

First and most importantly, a charity’s business model must align with the use of social investment. The business plan will need to show how investment capital will be paid back including any risk premium and interest. It will need to clearly identify the revenue-generating activities e.g. new business ideas, and be flexible to ensure that the model is sustainable even if income and expenditure vary against expectations.

Our research identifies that the size of the charity or the area it works in are not significant. All charities see a future shift of around 11 per cent towards social investment and borrowing and away from grants and donations. The corollary is that business models are key and taking the time to understand how social investment can be used is critical.

In addition, our work consistently highlights that charities need good-quality case studies to which they can refer and hands-on practical advice on how to implement.

Funding pressure in the charity sector is leading many charities to diversify their income streams and find new ways of ensuring financial sustainability. This appears to be the main reason at present why charities are attracted to social investment. A model that is replicable and scalable through social investment also plays well to most charities with ambitions of growth. Equally, creating funding models that will relieve the pressure of statutory funding may be appropriate as the squeeze on government funding continues.

Symposium discussions pointed to the fact that interest rates in the market are historically low and therefore ‘cheap money exists at the moment’. However, charities should be careful to ensure that any social investment taken is sustainable in the future. Ultimately, the charity will need to pay back the money they have borrowed plus interest and the ability to do this may depend on future interest rate levels.

Charities could potentially use their reserves as investment capital

One of the most exciting propositions is the potential use of existing charity reserves as social investment capital to help other social projects (either within the same charity or externally).

Our survey shows that 23 per cent of charity respondents feel that they have surplus reserves that could be used to do more. A charity could purposefully make social investments into other charities or social enterprises to increase impact. Alternatively, a charity could use its reserves, for example, as security for external borrowing without depleting reserves, to leverage fundraising, or to start a new social enterprise.

Existing staff can often act as ‘intrapreneurs’ – effective and dynamic internal social entrepreneurs empowered to drive impact forward. We have seen that by investing in their staff, charities are often able to come up with business ideas based around a social investment model that aligns powerfully with the existing business of the charity.

 **Lend with Care** (www.lendwithcare.org) was developed by the charity CARE International by using its reserves to build a peer-to-peer lending platform for microfinance in the developing world. This provides a new sustainable way of doing business while being impactful by helping the poor people the charity serves. It has now lent over £15m to the poorest across the world.

In summary

Any charity considering the use of social investment should be careful to develop a business model where generating impact goes hand-in-hand with ensuring that investment capital can be paid back.

There is a need to develop good-quality case studies, provide hands-on practical advice to build confidence, and build the capacity of financial management to spot opportunities and drive forward such tools as social investment.

Charities could consider using their reserves to invest in or to underpin new ways of working.

Dimension 2: Culture, mind-set and ethics

Culture and mind-set

The symposium highlighted that **there is considerable cultural resistance towards using investment in the charity sector**. The mind-set of charities is focused on grants, donations and delivering a social impact. It stands apart from much of the commercial world and its profit-driven motivation. This tension needs to be overcome in order to bring the two elements of social investment together.

Charities are often stuck in a grants and donations mind-set. They feel conflicted about 'investment' when they think about 'charity' and cannot see the link between the two. Our research shows that charities are mainly comfortable in their existing funding models and often have no impetus to change.

The survey clearly highlights that those charities that tend to be positive about social investment will consider borrowing for most purposes. Those that are negative won't borrow for anything. This is a clear cultural divide in the sector, which again lies around understanding social investment and how it can deliver impact for charities.

In each case we need to identify how to break down cultural barriers and negative mind-sets towards social investment in order to use it as an effective tool.

Understanding social investment

Building understanding of social investment is key – our research shows that if organisations understand social investment, they are most likely to use it and think positively about it (+20%) and if they don't understand they are less likely to use it and will think more negatively (-24%). (See **Q23 in Appendix B** for more details.)

Many in the sector are embedded in a mind-set of grants and donations and don't see the need to change or use new tools, despite concerns over future funding. We now need more sector money focused on training and mentoring charities through this change, and money to help build understanding of social investment.

A number of resources to build the understanding of social investment are available already and details can be found in **Appendix A**. Cass CCE, for example, has launched a simple free-to-download toolkit on social investment as part of its Tools for Success guide series. It can be downloaded at www.cass.city.ac.uk/cce.

Ethics and equity

The symposium and accompanying conversations have identified ethics as being at the heart of why some charities do not feel comfortable with social investment. They believe that it is wrong to make a profit from social issues unless all profits are reinvested back into the charity and they should not go to pay a commercial third party. Our research has gone so far as to say that there is a demand for specific 'social' capital away from mainstream investments and banks, which avoids such perceived conflicts of interest. More research will be needed to understand this dynamic.

Different funders have different motivations and some may be financially motivated, e.g. mainstream banks, while others may be socially motivated, such as trusts, foundations and angel investors (venture philanthropists). A range of investors exists to meet different charities' needs (see more in [Figure 10 on page 42](#)).

The symposium also highlighted that some organisations were concerned that social investment could create mission drift and take them away from their main funding sources – grants and donations. There were multiple comments about potential concerns of 'marketisation of charities' (charities end up providing services for money, rather than focusing on the social value they can create for society).

Charities may feel that if a social investor is interested in helping to generate a social return they should make some tangible contribution by accepting a discount from a market rate of financial return. From the charity's perspective this equity could help create a sense of 'we are all in this together' and build the market. This potentially opens the market for corporate social responsibility ('CSR')-type projects with corporates.

In summary

We must find ways of allowing charities to explore the benefits of social investment. Good case studies, mentoring and support will be critical. Specifically, we must support trustees on this journey.

Similarly, we must do all we can to continue to build understanding of social investment in the sector through formal training, mentoring and capacity building. In this way charities can learn and decide whether or not a social investment model suits them.

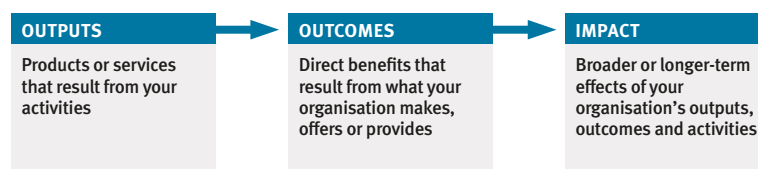
More research is needed to understand the ethical dimension and mind-set of charities when we talk about using investment tools. This will help us to understand the dynamics at play and break down the cultural barriers that exist.

Dimension 3: Impact measurement

Outputs, outcomes and impact

The ability to measure the social return on investment for a given financial return is key to the success of social investment. A charity needs to be able to measure its outputs, outcomes and impact effectively. An impact logic model ([Figure 9](#)) shows how outputs lead in turn to outcomes and finally impact.

Figure 9: Impact logic model (chain of outputs, outcomes and impact)



Our survey results show that while 72 per cent of charities say they can measure outputs and 65 per cent can measure outcomes, only 49 per cent can measure impact. Organisations are also concerned about the cost and time implications of measuring social impact, but without this, social investment is less likely to be forthcoming.

Our research highlights that it is often poor measurement practices that hold charities back, leading to lack of accountability and a charity's work being seen in 'financial' terms alone rather than a mix of both social and financial.

There was also wide agreement that social impact and social outcomes are difficult to measure, as is the attribution of a charity's work to social change. Therefore, to remove the burden of defining measures, these should be shared openly across the sector. This ambition is being taken forward by a beta website which forms part of a collaboration between organisations committed to improving access to information on investment and finance for charities and social enterprises. The Good Finance Outcomes matrix www.goodfinance.org.uk/impact-matrix is a tool to help organisations plan and measure their social impact. It includes outcomes and measures for nine outcome areas and 15 beneficiary groups.

Better handling and management of data was seen as critical for the future of social investment.

Similarly to other findings, small charities find it considerably more difficult to measure outcomes and impact than larger organisations do. To help build capacity, we need to invest in their development.

There is also a growing feeling that measuring social impact has become too complicated and has played to the investor agenda rather than that of charities. The social investment space is now starting to focus on less complex measures and attribute real social change to the programmes that underpin this through measuring outcomes. This whole area of measurement is at the heart of social investment and still in its infancy. Good conversations and training to build understanding are needed as well as a reduction in complexity and the cost of the measurement process.

In summary

To be able to use social investment the sector will need to focus on measuring outcomes and impact – the discipline of measuring non-financial information is seen as an important precursor to this. We should continue to share outcome and impact metrics and evaluations across the sector.

Finally, there is a critical need to focus on better management information and data handling if we are to achieve our ambitions around social investment.

Dimension 4: The team, capacity and investment readiness of the charity

A champion

Our research shows clearly that **where organisations have a social investment champion, this person can help take forward social investment and help others to see the potential**. Equally, it is highly correlated that those organisations where no champion exists typically do not even consider social investment.

The question then becomes how to identify a champion within a charity and give that person a voice. Many trustees have great knowledge of mainstream investment tools and could use their skills as the champion to rally around. However, we find that they can be very negative towards social investment, often being risk averse and feeling they cannot influence the charity's funding model.

Charity trustees

Our survey results show that on average the board are more positive about all areas of charity finance than both the CEO and FD. However, when considering social investment the reverse is true. While the CEO is most positive (+17%) and the FD more positive than not, the board is almost certainly negative (-20%). Most trustee respondents said they had a good understanding of charity finance and many have built professional careers and businesses using commercial investment tools. Addressing trustees' risk aversion towards social investment will be critical if social investment is to be successful. We welcome such initiatives as Big Society Capital's 'Get Informed' campaign (www.bigsocietycapital.com/get-informed) to help trustees understand social investment.

We are concerned that many trustees have become locked in a stewardship mind-set, where survival and financial viability alone becomes the de facto standard to judge the organisation's vibrancy. We must help trustees to look past this and see that the social impact and social change created by charities is what matters. We also need trustees to be able to take appropriate and well thought through risks and to innovate – taking on a generative mind-set, not just looking towards their fiduciary duties.

The team and the finance director

Interviews highlighted that many charities may have become locked into a certain way of working or thinking, focused on grants and donations. Staff with different ways of thinking, including those with the entrepreneurial flair to deliver the new social investment idea, will be important for success. Without this change in approach, the idea may fail.

There is a need to help charities build commercial propositions and take these to market effectively, as well as build capacity in those organisations so they understand how to use investment tools. Marketing a social business for example may mean selling products, which can feel quite different from raising grants and donations.

Our work highlights how culturally different this may feel. The new venture will need to focus on making money and this can be hard if your mind-set

is ‘nonprofit’. **Specifically, charity finance directors will need to change, evolve and gain new skills to deliver social investment.** Building their capacity to handle these new tools will be critical to future demand.

While subtle, these changes sit at the heart of why social investment sometimes fails. Thinking through the cultural and process changes in advance will improve the chances of success.

Our research shows that the cost, complexity and time required to take on social investment should not be underestimated and is considerably greater than most charities expected.

Legal and financial

As the social investment market develops we are seeing that much of the capital is agnostic on legal form. Social investors from charity banks and SIFIs (social investment finance intermediaries) are less concerned about the legal vehicle and more concerned with guaranteeing financial and social returns. For them it does not matter if investment returns are generated in a charity or social enterprise, for example.

However, the legal and financial nature of a charity does not allow for distribution of profits, nor for an investor to have an ‘exit’. We have learned from our interviews and work that charity vehicles may not be an effective and efficient way to take on social investment. We may need to find a different way for handling social investment, which protects social capital whilst allowing investors to share more effectively in reward. Some charities are starting to move away from a charity model precisely to allow themselves to trade, changing from charities to social enterprise models and community interest companies (CICs).

A specific problem was identified with restricted and unrestricted funds. Restricted funds are specific charity funds held in trust that can only be used for a certain purpose. The majority of grants are restricted, for example, and banks will not lend against these regardless of how good a charity may be at delivery or its previous history. When banks and investors consider lending to a commercial organisation they do not need to think about any legal restrictions on the monies that may secure the debt. This puts charities at a disadvantage. We need to find some way of addressing this inequity that restricted funds inherently bring to social investment and risk profiles for reserves.

How to build cross-over skills

Bringing cross-over skills into charities will be critical for the future growth of social investment. How do we safely let the private sector into charities and build motivation for both sectors to work together? Our research shows that building these long-term relationships takes time. However, we must bring in this new commercial DNA if social investment is to succeed.

Our work highlights concerns that SIFIs lack knowledge of the charity sector and regrets the lack of ‘real cross-over talent’ from those who have worked in the commercial sector but also have a good understanding of charities. The symposium also highlighted that for those organisations who have used social investment, it has been a very positive learning experience to look at an organisation in a holistic way and think differently about the charity – for example in the improved use of data.

In summary

Training and mentoring will be needed to help charities evolve – to understand what is required to deliver a social investment model and resource appropriately. Specifically, there is a need to work closely with charity finance directors to build their understanding and capacity.

We need to identify internal champions who can build social investment capacity, or alternatively management and trustees will need to get external help and support to identify the way forward.

We need to help build trustee understanding and appetite for social investment through targeted training and mentoring. Trustees are largely positive about all aspects of a charity's finance strategy, but negative about social investment. This is a specific barrier that we need to overcome.

We need to build cross-over talent between social organisations and lenders if we are to build the market for social investment.

Finally, more research is needed on legal forms and the potential models available for risk sharing between investor and charity. Restricted funds are a specific issue that will need to be tackled if charities are to operate on a level playing field with commercial organisations.

Dimension 5: SIFIs (social investment finance intermediaries) and government commissioners

Social investment finance intermediaries (SIFIs)

A critical part of the social investment ecosystem rests with social investment financial intermediaries (SIFIs). They build the market between investors and social organisations, helping to prepare charities and social purpose organisations for the change to social investment. They also find funding from different investors and act as brokers in this way.

The SIFI market is quite complex and a variety of funding models and products have developed. Many SIFIs, for example, focus on the Big Potential fund work, helping organisations to get investment ready and understand how to use social investment funds. SIFIs have links into a variety of investors from individuals to banks.

There is a wide range of SIFIs and these include organisations such as the Social Investment Business, Investing for Good, Numbers for Good and Social Finance. The SIFI ClearlySo have released a useful guide on finding funding – *Guide for the ambitious social entrepreneur*. Many SIFIs have a wide range of tools and guides to help develop skills and learning.

While many SIFIs are helping to build the market and are very good, some have come under criticism as they are both providing advice and finding investments. As such they may have a clear conflict of interest in acting both for the investor and charity. We have heard concerns raised in conversations that, in a way that is similar to regulated markets, there needs to be a much clearer divide between those finding funds and those giving advice.

On the whole, SIFIs are seen as a vital part of the social investment ecosystem as it develops. The symposium heard that most SIFIs were excellent and gave a good standard of advice, while some lacked deep understanding of the charity sector or lacked staff who could discuss the

sector's needs empathetically. It will be critical that the quality of their work and ethical standards is upheld.

Commissioners and policy

A significant portion of funding to the sector comes from central and local government and other commissioners of services. The policy environment needs to be enabled, risk-sharing approaches need to develop further and commissioners need to be trained. Equally, government needs cross-department working to focus on social value created. The symposium strongly acknowledged the leadership that had been shown by the Cabinet Office around this.

In summary

Ensuring the quality of SIFIs' work will be critical. Specifically, the social investment market must be careful to avoid any allegations of mis-selling if it is to maintain a good reputation – especially the reputational risk of mis-selling involving charities. This is a fledgling market that needs to avoid such risks at all costs.

We need to train commissioners of services within government to keep social investment at the forefront of their minds and also to develop further risk-sharing approaches. We also need to continue to enable the policy environment to be conducive to social investment.

Dimension 6: Alignment of purpose behind the investment

Investment motivation (mission alignment or finance first)

While social investment has the intent to create both a social and financial return, investor motivation seems to divide squarely between those who are making investments led primarily by their social mission, versus those motivated primarily by a financial return. Mission-motivated investors tend to target their investments towards specific causes and take on greater risk for a lower financial return to compensate for this ('mission-motivated investors'). Other investors are motivated by the return on investment they will generate ('finance-first' investors).

Similarly, investors are starting to cluster around specific themes, such as health and education. [Our research has shown that working together with the investor to define investment motivation and aligning this effectively is critical to build trust.](#) It can also enable investors to engage meaningfully with charities.

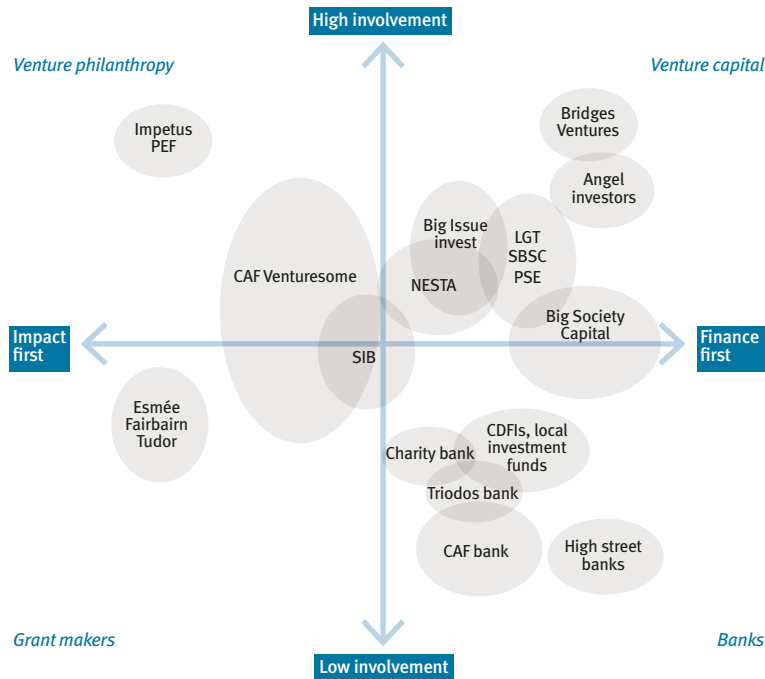
Investors will also consider the level of involvement they require with their investment – 'hands-on' or 'hands-off'. Those investors who have a hands-on approach may ask for a seat on the board or to work closely with the management team and CEO to shape delivery. This can be challenging as it means a partnering arrangement, but it can also bring new skills and capacities to charities.

The most powerful investments we have seen so far have been those where motivation has been clearly and effectively discussed and both charity and

investor understand what they each get from the investment. They are also careful to work together to create trust and a bond in a long-term partnering arrangement. Good SIFIs are also working with charities to build this trust.

Figure 10 has been recreated from a CAF (Charities Aid Foundation) diagram. It highlights the different investors in the social market and their primary motivation and approach to lending.

Figure 10: Different investors in the social market and their primary motivation and approach to lending



Source: CAF (Charities Aid Foundation)

Many charities simply do not realise that different investors have different motivations. Many also feel more relieved when they understand that not all funding comes from mainstream banks.

This enables them to address some of the ethical concerns they may have and see that not all funders are just looking to make a financial return from social issues – this is far from the truth. The majority of investors in this new social investment space, such as Big Issue Invest, take ethical and sector issues very seriously.

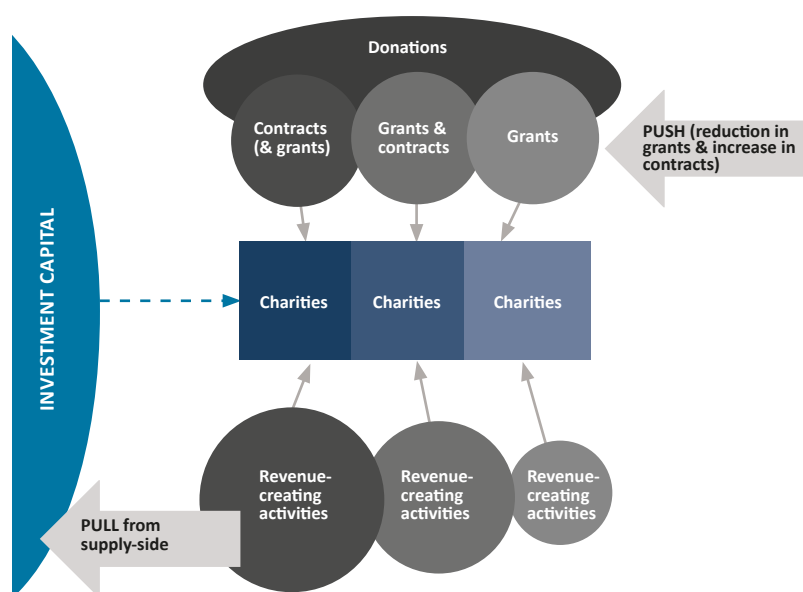
Undeniable force of investment

Our research looked at the market forces at play and saw a reduction in size and volume of grants and donations and a growth in the social investment market and 'revenue-generating activities'. It suggests that as social investment grows it will exert a strong force on the sector (**Figure 11**).

The push and pull on the charity sector is profound and there is an undeniable 'gravitational force' of trillions of dollars of investments.

We conclude that using investment tools in charities will change the sector as it evolves.

Figure 11: The 'gravitational' force of investment as grants and donations shrink and social investment grows



Darker colours show change over time

In summary

While social investment has the intent to create both a social and financial return, investor motivation seems to divide between those who are making investments led primarily by their social mission, versus those motivated primarily by a financial return. Mission-motivated investors tend to target their investments towards specific causes and take on greater risk for a lower financial return to compensate for this. Other finance-first investors are motivated by the return on investment they will generate.

Investors are starting to look at investing around themes such as health and education. Our research shows that aligning the motivation between a social investor and the charity can create something really powerful.

The symposium also highlighted that many investors take a charity's concerns on ethics very seriously, specifically mission-focused investors such as Big Issue Invest, which sees itself very much as providing 'social capital' to the 'social sector'.

The final finding is the undeniable force of investment that exists. There are trillions of dollars of investment in the world available from investors with many different motivations. As grants and donations shrink, social investment funding will exert its force on the charity world in both the short and long term.

Dimension 7: Balancing three forces – social return on investment (ROI), financial ROI and risk

Balancing three forces

When considering a commercial investment, investors typically weigh up the financial return on investment against the risk of that investment to come to an acceptable return. The greater the risk, the higher the return investors need to compensate for the risk. Social investment adds a further dimension to this, namely the generation of social impact and the risk associated with its delivery.

The balance of three forces – financial return, social return and the associated risk – is the critical conversation and negotiation that charities need to have with investors. It is often difficult to measure the social value and that can lead to the perception that social investment is complex.

Each social investment should be underpinned by clear metrics (social as well as financial) and an intentionality to be transparent about the social value created and to report openly about this. The difficulty comes with valuing the social return on investment and this is open to interpretation.

Measuring social value – the complexity

Consider a well dug in Africa to provide water.

The **inputs** to build the well are bricks, digging, time and labour.

The **output** from the well is fresh water.

The **outcomes** from this are better health for the community, less time spent (especially for women) walking to collect water, more time for education and commercial activities and farming.

The **impact** is greater life choice for communities and greater GDP.

Most social investments measure at the outcome level.

We are starting to see a range of ways of pricing the social return on investment and also a range of different investment tools developing – equities, quasi-equities, bonds, social impact bonds, crowd-funding and loans – to handle this. Some investors are asking if we can incentivise interest rates to generate greater social returns.

The theory is that investors will trade off their full financial return for a greater social return on investment, coming to a ‘blended’ return. The reality is that different investors have different motivations, as we saw in [Dimension 6 on page 41](#). We are also all at the start of a journey of how to price the social return on investment and so both charities and investors lack sophistication in this conversation. Investors are concerned about risk and the costs of assessing social return measures; charities are concerned about paying high rates of interest – putting this another way, in the eyes of the investor, charities want access to high-risk capital at low cost. In the eyes of the charity, they see this as an expensive form of capital.

Charities have complained about the length of time and person hours that the due diligence, required by an investor, takes. This whole area is worthy of considerable further research.

Equally, many investors suggest that the deal size is too small. It is complex and costly to put social investments in place, so one of the key issues is how to capitalise small deals to allow smaller charities and social purpose organisations into the social investment space. The Access Foundation is the latest initiative to wrestle with this problem and is focused on blending social investment capital with grants to address this.

What do investors consider?

Investors are, on the whole, excited about the possibilities that social investment brings. For example, The Method Impact and Financial Times report, *Investing for global impact*, shows that over the past few years family offices and foundations have moved from thinking about this and gaining specialist knowledge to making their first fledgling investments. Mainstream banks such as UBS, Barclays and JP Morgan have also set up teams to start focusing on this.

Investors are fully aware of the effort it will take to bridge the gap between investors and charities, but see this as something that their clients want. This shift towards using money for good is a growing trend across the world.

Nevertheless, investors believe that money will flow like water and if eventually social purpose organisations don't make use of social investment then investors will go elsewhere in the long-term.

Investors often go through a screening and mapping process when considering a portfolio of investments – screening to identify investments that fit their criteria and mapping to ensure they can identify where those investments will fit in their portfolio.

However, investors are frustrated by the legal form of charity and how they get money into a charity and exit successfully. This may mean they are more predisposed to invest in a social enterprise or other 'profit with purpose' company, for example. They are also surprised at how slow the decision-making process is within charities.

Further research is certainly needed in this area to understand these barriers from an investor perspective.

In summary

Balancing the social and financial return on investment against the risk of the investment to come to an appropriate rate of return is the key conversation in social investment. Furthermore, each social investment should be underpinned by clear metrics (social as well as financial) and an intentionality to be transparent about the social value created and to report openly about this.

Investors typically focus on outcomes-based measures and this has the advantage of giving the charity flexibility of how it delivers these outcomes to achieve payment.

However, measuring the social return on investment can be complex, so it can be both time-consuming and costly. This has led some investors to identify that charities wanting social investment capital exhibit high risk but want cheap capital and are finding it hard to resolve this dilemma.

Charities have complained about both the length of time and person hours due diligence takes. Investors suggest that deal size is too small. If the social investment market is to evolve, we need to simplify and standardise measurement and costing practices and create a wide range of investment products to meet demand. This whole area is worthy of considerable further research.

Many investors are excited about the possibilities that social investment brings and see that their clients are also interested. They even talk potentially about a whole new asset class in their portfolios. The Social Stock Exchange is also helping to build social investments that can be traded successfully and taken to scale. It allows charities to raise capital through placing their offer on mainstream markets and creating tradeable opportunities for investors.

Our research is starting to see a tipping point where social investment is gaining momentum and traction to move into the mainstream and away from being seen only as a ‘niche’ product.

We are starting to see more ‘blended products’ mixing social and financial returns. Equally, investors believe that money will flow like water and if eventually charities don’t make use of social investment then investors will go elsewhere.

Dimension 8: The type of investment, price and terms

The type of investment, price and terms

A full review on the type of investments and their pros and cons is beyond the scope of this report; a basic list of potential investment types is given in [section 4.1](#).

Often social investment occurs between a single investor and a single charity. Equally, some of the investments made to date have multiple lenders to spread the risk to any one investor. Who takes on the ‘first-loss position’ is critical. If a charity is able to put up some reserves to underpin this ‘first-loss’ position it can de-risk the investment and lead to a significant reduction in costs through better negotiations.

The key learning from our research is that different charities have very different business models and demands for social investment and one size doesn’t fit all. SIFIs and the intermediary market will be critical to help charities understand the breadth and depth of products available. Training and mentoring will also be important.

Different types of capital

Several years ago most social investments were made against asset-backed models to provide security to the investor e.g. through property which can be held as security. Boston Consulting Group and Big Society Capital’s report (Brown and Swersky, 2012), *The first billion*, identified that in 2011, 84 per cent of investments were **secured**; in 2015 they expected 73 per cent to be **unsecured** or quasi-equity and risk taking. The market is changing.

Charity models don't allow equity sharing and many investment models are focused on equity, not debt. Our research highlights the need for the social investment world to keep innovating to provide a wide range of investment products to meet all demand and supply requirements.

It is interesting to note that crowd-funding has been growing more quickly than social investment during the same period and this is allowing different models to develop, giving communities a chance to lend capital through CDFIs (community development investment funds) on a local basis. The rise in pubs purchased from community bond issues is a good example of this.

What is needed is long-term patient capital with varying time horizons that is able to stay with a charity as it develops using social investment.

We would encourage corporate organisations to provide funds and to go beyond corporate social responsibility to produce a win-win arrangement. Corporates need to provide funding to projects that align with their mission. An example is the Barclays 'Banking on Change' project that helps build financial inclusion across Africa and helps bank the poorest into the system.

Example of a win-win financial arrangement

An NGO and commercial organisation team up to provide sanitation in Africa. The NGO would be happy to meet the water and sanitation needs of slum dwellers while the commercial organisation could bring know-how and commercial skills, while focusing on profit-making endeavours for its shareholders.

In summary

The key learning in building the social investment market is that one size does not fit all. We need SIFIs and intermediaries to help shape products that really work for the charity space. We have identified that long-term capital is needed to take charities on this journey. Training and mentoring will also be important.

We note the move away from asset-backed investment models and towards unsecured borrowing. Our research highlights the need for the social investment world to keep innovating to provide a wide range of investment products to meet all demand and supply requirements.

There is a need to find capital at all stages of growth and not just for innovation or taking to scale. Specifically, 'proof of concept' funding will be critical to enable growth in charities.

Finally, we look towards corporate organisations to provide investment funds and to go beyond corporate social responsibility to produce a win-win arrangement; to provide investment opportunities that are profitable as well as offering real opportunities for beneficiaries.

Dimension 9: Language and terminology

We have highlighted the **considerable cultural barrier towards using investment tools in the charity sector**. The mind-set of charities is focused on grants, donations and delivering a social impact. It stands apart from much of the commercial world and its profit-driven motivation.

Part of this division is based around language and terminology.

Our symposium highlighted two language barriers that are starting to hold back the development of the social investment market:

- The first is the confusion around the proliferation of terms – social investment, social finance, social impact investing.
- The second exists between charities and investment providers.

Social Finance Investment Intermediaries (SIFIs) are helping to bridge this communication gap and build from both sides; they have a critical role to play.

Nicholls and Daggers suggest in their 2016 paper – *The landscape of social impact investment research: trends and opportunities* – that this all sits under an umbrella term, **social finance**:

‘Social finance encompasses the use of a range of private financial resources to support the creation of public social and environmental value or impact ... As such, social finance encompasses a range of models and research topics including: Islamic finance; mutual finance; crowdfunding; community finance; targeted socially responsible investment; and social enterprise financing.’

This paper identifies that **much further work will be needed to bridge the terminology divide**, not least to enable academics and practitioners to understand clearly the range of different social investment vehicles and be able to talk about these with real clarity.

In summary

We see that two elements of language and terminology are starting to hold back the development of the social investment market, namely the confusion around the proliferation of terms and the language barrier that exists between charities and investment providers.

We feel that more work is needed to bridge this terminology divide to enable charities and investors to talk effectively.

4.4 Summary

- While hard to define, social investment is an easy concept to grab hold of. It uses more commercial-style investment tools to create a social as well as financial return to fund charities. For the purpose of this work, we have identified that definitions around social investment are contested, fluid and perhaps an irrelevance to actually doing the work. We use the following definition in our work:
‘Social investments have the intent and motivation of generating a social or environmental impact as well as financial return on investment. They aim to measure both the social and financial value they create and be held accountable for this.’
- Social investment cuts across size, theme and scale of different charities. In fact we have identified that it needs a change in mind-set and is seen as a distinctly different funding mechanism from grants, donations and contracts.

Business models therefore become key, as does the understanding of social investment. Case studies and mentors are important if the social investment space is to grow.

- 71 per cent of charities see social investment as appropriate, but when considering any move towards social investment, a charity will need to revisit its activities and finance strategy to ensure that they can pay back what they have borrowed. Equally, social investment does not have to be complicated. Small loans are one of the most powerful investment tools to help growth.
- Our work has identified that charities want two things from social investment:
 - Money that is affordable
 - Money that will help them build sustainability and predictable income streams.
- Given that charities want predictable income streams and sustainable business models, demand for social investment will perhaps grow more strongly where this is seen as the prime focus.
- Social investment is not a silver bullet and takes time and effort to implement. However, some charities, such as those mainly funded from grants, see this as a good way forward, perhaps having rose-coloured spectacles as funding becomes scarcer. We need to do more research to understand the business models and motivations that could drive demand.

What are the different dimensions of social investment?

The report identified that any social investment has nine key dimensions to consider:

1. The business model and funding strategy
 2. The culture, mind-set and ethical considerations behind the investment
 3. The measurement of social impact
 4. The team, capacity and investment-readiness of the charity
 5. The intermediaries and funders – SIFIs (social investment finance intermediaries) and government commissioners.
 6. Alignment of investment between investor and charity
 7. Balancing social ROI vs financial ROI and risk
 8. The type of investment
 9. Language and terminology.
- There is a considerable cultural barrier to using investment tools in the charity sector. Charities are often stuck in a grants and donations mind-set. They feel conflicted about ‘investment’ when they think about ‘charity’ and cannot see the link between the two. We see the battle between ‘head and heart’ as synonymous with the financial and social return on investment that is the intent of social investment and forms the title for this report.
 - Building understanding of social investment is key – our research shows that if organisations understand social investment, they are most likely to use this and think positively about it (+20%) and if they don’t understand they are least likely to use it and will think negatively about it (-24%). We need to develop training and mentoring for the sector.
 - Our research shows clearly that where organisations have a social investment champion, this person can help take forward social investment and help others to see the potential. Equally, it is highly correlated that those organisations where no champion exists typically do not even consider social investment.

- We are concerned that trustees are positive on almost all aspects of charity finance strategy, but are 20 per cent more negative on social investment than the CEO or FD. Addressing this risk aversion towards social investment in trustees will be critical if social investment is to be successful.
- Our research shows that working together with the investor to define investment motivation and aligning this effectively with the charity is critical to build trust. Many charities simply do not realise that different investors have different motivations, and charities have ethical concerns about social investment because of this. Many charities also feel more relieved when they understand that not all funding comes from mainstream banks.
- There is a 'gravitational force' of investment. There are trillions of dollars of investment in the world with many different motivations. As grants and donations shrink this will exert a more pronounced force on the charity world.
- Equally, investors believe that money will flow like water and if eventually charities don't make use of social investment then investors will go elsewhere.
- The symposium showed that what is needed is long-term patient capital with varying time horizons that is able to stay with a charity as they develop through social investment.
- Finally, we identified that to stand the best chance of implementation, charities need to potentially change their DNA and invest in those with different skill sets. Developing a business plan and working out how to best take this to market is critical.

4.5 Conclusions and recommendations: social investment as a tool

FINDINGS	CONCLUSIONS & RECOMMENDATIONS
General ■ There is general lack of understanding about what social investment is and how it can be used. ■ Charities often think that social investment is complicated. ■ Charities lack good examples and case studies of social investment. ■ The sector also lacks clear definitions with which to take social investment forward, although these are starting to emerge.	Recommendations ■ The sector needs to continue to build learning and understanding about what social investment is and how it can help them. ■ Special focus needs to be placed on developing case studies, training and mentors to help charities see the possibilities for using social investment. ■ The social investment sector needs to continue to develop definitions and terminology.
Business models ■ Charities don't always understand their business models and growth phase and how social investment can help them. Every organisation is different and each will have a different type and model of funding which fits them. ■ Social investment is not a silver bullet.	Conclusions ■ Charities want funding that can help them build sustainability and predictable income streams. Social investment achieves this. ■ Don't try to judge organisations on size, scale or topic. Business models are key when considering social investment, as is understanding how this can be used in different growth phases. Recommendations ■ The sector needs to continue to innovate and develop a wide range of products for social investment. ■ We need to invest in education and critically with small charities and trustees to build the understanding of future business models and how social investment can fund growth in charities to a more sustainable size.
Governance ■ Currently organisations are in a stewardship mind-set focused on sustainability. ■ Trustees are generally risk averse and are mainly positive on charity finance, but negative on social investment. ■ Finance directors will need specific training to be able to understand and use social investment effectively.	Conclusions ■ Charities generally will need entrepreneurial DNA to successfully implement social investment. ■ We also need to address trustee risk aversion towards social investment to achieve this. ■ Charities will need: – Passionate trustees with a clear view of the bigger picture – Ethos based on outcome and impact – Change management to support change – A broad range of experience on the board. Recommendations ■ We need to continue to build understanding of social investment. Trustees and finance directors will need specific training and case studies. For example, we welcome the 'Get on board' initiative from Big Society Capital. ■ The sector needs critical challenge and training to move away from its current mind-set towards social investment, growth and innovation. ■ We potentially also need to see the evolution of charity governance that is more in line with investment and commercial models.

Conclusions and recommendations: social investment as a tool (continued)

FINDINGS	CONCLUSIONS & RECOMMENDATIONS
Capital ■ Charities want flexible, cheap capital. ■ Charities also want long-term patient capital. ■ Charities want money to help them become more sustainable and with predictable income streams. ■ Investors are driven by a motivation – either to focus on social return (mission driven) or financial return (finance first). ■ Investors have concerns about the size of investments and modest returns for perceived high risk. ■ There is an undeniable ‘gravitational’ force of investment capital in the markets that will pull more charities towards social investment as a tool in future. ■ Aligning investor and charity motivations to use social investment gives a powerful combination.	Conclusions ■ Further capital needs to be encouraged to enter the sector across a broad range of investors, with a wide range of motivations and size of investments. Specifically we need to encourage longer-term patient capital. ■ We also need the sector to keep developing and refining social investment models. ■ We need to develop ways of keeping cost down and standardising ways of providing small value capital in a less expensive way. Recommendations ■ Broad awareness-raising will continue to be needed across the investment market and within international markets. ■ SIFs need to continue to build the market and garner further investment capital into the sector. We need to push on creating long-term patient capital. ■ We need to research investment models and motivations.
Measuring returns ■ Charities need to have good systems for measuring outputs and outcomes before they can focus on using social investment. ■ They need better data management to achieve this.	Conclusions ■ A focus on measurement is needed across charities if social investment is to be successful. ■ We need initiatives and resource to focus on data management. Recommendations ■ We need to build capacity in impact measurement and data management within charities. ■ We need to share best practice.
Pricing ■ How to trade off social and financial returns versus risk is the key issue in social finance. ■ Pricing social outcomes is difficult.	Recommendation ■ We need the sector to keep developing and refining social investment models, measurement models and pricing mechanisms.

Conclusions and recommendations: social investment as a tool (continued)

FINDINGS	CONCLUSIONS & RECOMMENDATIONS
Mind-set ■ Serious cultural barriers exist to charities using investment tools. ■ Charities may feel conflicted between the word ‘charity’ and the word ‘investment’. ■ There are ethical concerns about using investment tools to make undue profits out of charities and social issues.	Conclusions ■ Ethical questions exist about using social investment in charities. These must be addressed and recognised rather than being swept under the carpet. ■ Unless these questions are resolved some charities will not use social investment. ■ A disconnect exists between the mind-set of the funders and the organisations (charities and social enterprises) that might make use of social investment. They do not speak the same language. Recommendations ■ There is a problem with the word and mind-set associated with ‘charity’ which when mixed with the mind-set of ‘investment’ proves to be incompatible. We must continue to build bridges between the two communities, through training, case studies and to develop opportunities for new investment models to take root.
SIFIs and commissioners ■ Ensuring the quality of SIFIs is critical. ■ There is an inherent conflict of interest for a SIFI in both being an introducer to a provider of capital and advisor. This will have to be managed. ■ We need to train the commissioners of central and local government services in the use of social investment.	Conclusions ■ Quality control mechanisms will need to be developed by SIFIs and transparently reported. ■ Commissioners of central and local government services will need to be trained in the benefits and issues of social investment models. Recommendations ■ A proportionate regulatory regime for the social investment environment will need to continue to be developed to ensure quality among advisors and providers of capital, along with light-touch red tape to ensure the social investment space can continue to innovate and grow. ■ Training commissioners of local and government services and providing good case studies will also be important.



Charities are often inquisitive,
but lack understanding to progress
the use of social investment

chapter 5:

Building the market for social investment

5.1 Supply and demand

Progress so far: supply of capital

The Big Society Capital (BSC) report (2016a) *The size and composition of social investment in the UK* highlights that currently there are some 3,500 separate social investments across the UK with an aggregate value of £1.5bn, around 47 per cent of those sitting within charities. Furthermore, around 17 per cent of social investment capital is coming from BSC, followed by trusts and foundations at 11 per cent and high-net-worth individuals and ‘angels’ both at 11 per cent. There is a tail of other capital from banks, high-net-worth individuals and other investors.

BSC (as a wholesaler of investment funds) does not invest directly but places capital with SIFIs to build the social investment market on their behalf. The SIFI market continues to develop and is now much more able to meet the needs of the charity sector, both in terms of capacity and understanding. There has been some criticism of SIFIs’ understanding of charities and the quality of their work with investees and also some criticism of ‘money chasing’ attitudes. However, on the whole, excellent SIFIs such as Numbers for Good, Social Finance, Investing for Good and the Social Investment Business have helped develop the market. BSC has placed funds with SIFIs focused on a wide range of themes ranging from ex-offenders, adoption and rough-sleepers to health and ageing.

Supply of investment capital is also starting to build from family offices and foundations and the Method Impact and Financial Times *Investing for global impact* report of 2015 highlights that whereas family offices were merely thinking about this two years ago or taking advice from experts, they are now making their first investments.

The introduction of the social investment tax relief (‘SITR’) is also likely to facilitate more people using social investment as a tool. UBS released the first SITR fund in 2015 and others look set to follow.

As the social investment market develops we are seeing that much of the capital is agnostic on legal form. Social investors from charity banks and SIFIs are less concerned on the legal vehicle and more concerned with guaranteeing financial and social returns. For them it does not matter if investment returns are generated in a charity or social enterprise, for example.

However, the mainstream banks are playing catch-up. While for some banks social investment is often seen as no more than corporate social responsibility (CSR), organisations such as JP Morgan and Barclays have dedicated staff focused on social investment as part of their core business.

Finally, the size of individual investments and loans is coming down. Historically investment size was large and in the region of £150,000 upwards, which has led to the development of Access – The Foundation for Social

Investment, to facilitate small-value loans and investments typically in the £50,000 to £150,000 range. Access is acting as a champion for charities and social enterprises at the early stages of development, providing finance and support for growth.

Demand: the state of play

Against the total sector income of £43.8bn (NCVO Almanac, 2015) our findings suggest that between 10–14 per cent (average 11 per cent) more demand for investment and borrowing will be required by charities in the next five years – equivalent to £4bn–£6bn capital. This sits against the existing levels of borrowing and social investment (£4.2bn) in charities, roughly double. Our findings point to a growth rate of 26 per cent per annum compound growth – this is considerably less than the current 38 per cent per annum growth.

Grants and donations will still be the main form of funding for the sector, but the sector is starting to embrace the use of social investment and borrowing as a tool.

Aside from the growth in the aggregate level of investment funds available and the increase in social investments made, we have seen a large increase in social impact bonds across the UK. We have also witnessed the ongoing rise in crowd-funding and microfinance initiatives.

New launches have continued at pace and have moved away from asset-backed secured investments towards more risk-taking ventures.

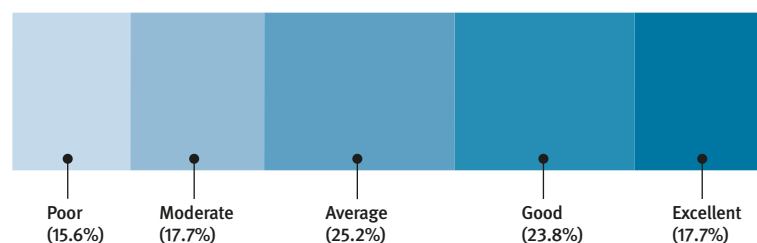
5.2 Survey results

This section summarises the findings from the second theme within our survey, which asked for responses concerning social investment. The detail of the results can be found in [Appendix B](#).

Organisation understanding of social investment

Individual charities are in very different places regarding their understanding of social investment – this is highlighted by the broadest spectrum of results in the survey ([Figure 12](#)).

Figure 12: How respondents rated their organisation's understanding of social investment from 'poor' to 'excellent'



However, understanding is highly correlated to the size of the organisation. Smaller charities have less understanding than larger organisations – perhaps reflecting that larger charities have more resource and are able to scan current trends more effectively. They also have the staff resource to invest time and energy learning about this.

The shift in funding models

We asked charities to consider how much they felt their business models would move from grants and donations towards borrowing and investment within five years. We specifically asked: ‘What does your funding model look like now, versus what will it look like in five years’ time, between grants and donations on the one hand and borrowing and investment on the other hand?’

All charities saw their funding mix moving, even those who were negative about social investment. INGOs perhaps saw the greatest opportunity in social investment, with a 23 per cent shift in their funding models.

Figure 13a and Figure 13b show a comparative movement away from grants and donations to borrowing and investment over the next five years (see also Q19 in Appendix B).

Figure 13a: Expected change in funding models over the next five years (from grants and donations to borrowing and investment)

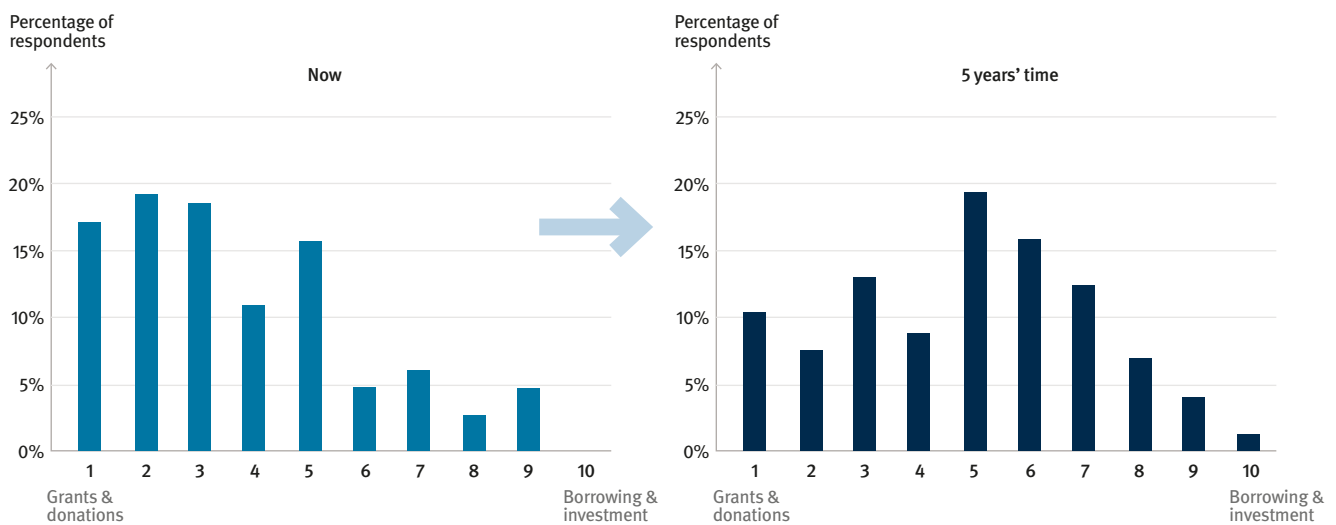
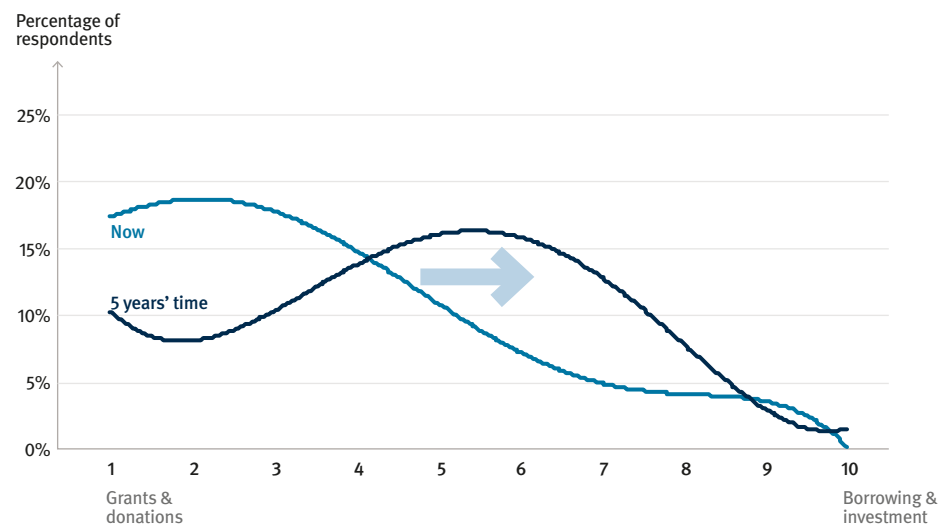


Figure 13b shows the same data as Figure 13a recreated as smooth graphs to show comparative movement.

Figure 13b: Comparing expected change in funding models over the next five years (from grants and donations to borrowing and investment)



While there is a positive shift across almost all organisations, the responses do not appear to be correlated on the ability to measure impact, nor to any degree on the type of organisation or the theme it focuses on. From our interviews and research, we believe **this correlates to the business model in each individual charity being the most important driver of whether or not an organisation would use social investment.**

Organisations continue to see grants and donations as their primary funding. However, social investment does provide a new tool that can be used to fund their ambitions. Those who receive their funding primarily from grants saw their models shifting further than both fundraising organisations and those that already use social enterprise, perhaps due to the pressure on them to find new funding models given the recent severe cut backs in government funding, or perhaps false hope and optimism that social investment could offer a rapid solution.

What will organisations use social investment for?

We then asked organisations what they would borrow for. In stark contrast to the positivity about social investment in the previous question, the results show that many would not borrow for working capital, fundraising or even for property. Equally many would not borrow to start a new project or programme.

Organisations see their businesses as evolving towards social investment and borrowing, but don't fully understand what they would use the money for.

Our analysis shows again that social investment models are very much dependent on the organisation concerned. Some who were negative about social investment would borrow for property. Others who were positive would not borrow for cashflow. This is a very mixed picture and again indicative of borrowing and investment being specific to each individual organisation.

Where charities would go to get funding

This question identified that about 60 per cent of organisations said they knew where to get funding, while 40 per cent did not. Again this seemed to correlate with the size of organisation, with small organisations less likely to know where to go. Small charities will need more help to understand social investment and where to go to get funding.

Some 54 per cent of organisations would go to a bank to get funding, while 39 per cent would go to a social investor. However, the narrative answers show that while many charities are aware of bank borrowing, they are not aware of what social investors, foundations and SIFs have to offer. We need training and awareness-building to develop the market. This is backed up by narrative comments in our survey:

'If the right business case can be made, then I would consider borrowing on a straight-forward 'plain vanilla' loan-type basis for social enterprise-type development. This might be through specifically social investment intermediaries but I would also assess straight commercial borrowing as it can be equally competitive in the right context.'

Key barriers

The key barrier to building the social investment market is understanding (see Q23 in Appendix B for further barriers). Deeper analysis of the data shows that if organisations understand what social investment is, then

they are most likely to use it and think positively about it (+20%) and if they don't understand they are least likely to use it and will think more negatively (-24%). The barriers considered in the narrative answers are both internal and external (Figure 14).

Concerns were raised on the cost and complexity of social investment, as well as the length of time it takes to go through the lending process compared to grant funding and fundraising. There was a range of answers about how well equipped organisations and trustees are to proceed with social investment. Again it shows that each organisation will need something different to help them on the journey towards social investment. Smaller organisations and those financed mainly from fundraising need more help to build understanding.

Figure 14: Barriers to building the social investment market

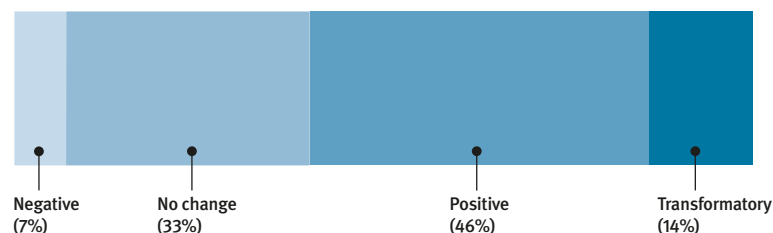


Narrative answers were unequivocal – 38 responses (over 50 per cent of all responses) highlight a strong call for much-needed education in finance and social investment. Typical of quotes was this:
'There is a lot of talk about social investment but not much practical, hands-on support. The social investment bandwagon is asking charities to jump too far without providing a bridge of practical support.'

How positive charities feel towards social investment and borrowing

The final question is the key to unlocking the sector's potential to take on social investment. There is a wide range of opinions on social investment and borrowing and this is reflected in the respondents' views (Figure 15).

Figure 15: How respondents felt social investment and borrowing would affect their organisation



Forty per cent of charities feel that social investment will bring little or no change to their organisations or are openly negative about it. However, **60 per cent** see social investment and borrowing as either positively changing their business models or being transformational to them.

The organisations who feel this will be transformational (14 per cent) tend to be those currently funded by grants, while those who currently use social

enterprise to fund their organisations typically sit in the ‘positive’ category. This may highlight wishful thinking on behalf of those organisations funded by grants currently feeling intense funding pressure.

While large and major charities are most positive, small charities are also positive. It is only medium-sized charities that are not; we are unclear as to the reason why, but speculate that this is because they lack resource, space and time to think otherwise. Organisations predominately financed by fundraising are the least positive.

Those most positive towards social investment believe they have a good understanding of it. This is highly correlated and each organisation that has successfully implemented social investment has done so from a position of real understanding, as well as having the ability to re-skill their staff to meet the different funding needs.

Given the strong linkage between positivity and understanding about social investment, we should put our effort into building demand through teaching, lecturing, mentoring, good case studies and support.

5.3 Summary

Supply of funds

- The market for social investment continues to build and has reached around £1.5bn capital according to the latest figure from Big Society Capital. The average size of individual investments and loans is coming down, which is meeting the demand for smaller loans within the sector. However, a gap has started to develop between supply and demand and social investors are looking for good quality opportunities to invest in as the market develops.
- Our research has identified a tipping point where social investment is gaining momentum and traction to move into the mainstream and away from being seen only as a ‘niche’ product.
- Some commentators are saying that the social investment is not growing fast enough. Our research provides a contrary view and finds a sector that wants to explore and learn. Charities are often inquisitive, but lack understanding to progress the use of social investment.
- There is a clear conflict of interest in the SIFI market where organisations both give advice and create investment products. We need to move to a more regulated model where retail and professional clients are identified and advice and selling of investment products are separated (this will reduce nervousness from trustees and focus on impact vs finance). We must be careful of the danger of mis-selling.
- We need to train local authority and government commissioners to keep social investment at the forefront of their minds and also to develop further risk-sharing approaches. We also need to continue to enable the policy environment to be conducive to social investment.

Demand for funds

- Despite borrowing and investment playing a modest role within the financial strategy of most charities at the moment, over the next five years it is expected to grow. Charities see a shift towards social investment and borrowing of around 11 per cent of their funding model and away from grants and donations. This is equivalent to £4–6bn of capital.

- In our survey, all charities see their funding mix moving towards more social investment and borrowing, even those who are negative about social investment. From our interviews and research, we believe this correlates to the business model being the most important driver of whether or not an organisation would use social investment. Understanding is highly correlated to the size of the organisation however. Smaller charities have less understanding than larger organisations.
- We asked what a charity would use social investment and borrowing for (in contrast to general trends). Our survey results show that many charities would not borrow for working capital, fundraising or even for property, when pushed for the detail of what they would borrow for. Equally many would not borrow to start a new project or programme. It is therefore interesting to reflect that organisations see their businesses as evolving towards social investment and borrowing, but don't understand what they would use the money for. Our analysis shows again that social investment models are very much dependent on the organisation concerned.
- The key barrier to building the social investment market is seen as understanding. Narrative answers are unequivocal, with 38 responses (over 50 per cent of all responses) highlighting a strong call for much-needed education in finance and social investment.
- INGOs perhaps saw the greatest opportunity in social investment, with a 23 per cent shift in their funding models.
- 40 per cent of charities feel that social investment will bring little or no change to their organisations, or are openly negative about it. However, 60 per cent see social investment and borrowing as either positively changing their business models or being transformational for them.
- The most positive are those who understand social investment and it is here that we should concentrate our efforts to build demand through teaching, lecturing, mentoring, good case studies and support.

5.4 Conclusions and recommendations: building the market

FINDINGS	CONCLUSIONS & RECOMMENDATIONS
Supply and demand ■ A large amount of capital already exists in the social investment market and supply of funding is healthy. ■ Similarly, demand is growing for social investment into charities. Our figures show this could rise to £4–6bn within five years at a growth rate of 26% per annum. ■ The SIFI (social investment finance intermediary) market is vibrant and growing. ■ A gap exists between supply and demand that will need to be bridged and investors perceive the social investment market to be growing slowly. ■ There is an absence of 'investment-ready opportunities'.	Conclusions ■ There are several key barriers that need to be addressed: – Understanding of social investment – Perceived cost of social investment – Perceived complexity of social investment – Absence of suitable products – Lack of mutual understanding between investors and charities – Issues with charity governance – Trustee risk aversion, mind-set and culture. Of these, understanding of social investment is the main barrier. ■ Social investment is not a silver bullet and is not suitable for all charities. Recommendation ■ We need to continue to break down barriers, but to do this we need to build understanding on both sides – supply and demand.

Conclusions and recommendations: building the market (continued)

FINDINGS	CONCLUSIONS & RECOMMENDATIONS
Growth in the market ■ All charities across the sector saw the growth in social investment as a positive tool, as well as a rebalancing of funding models. This was consistent across size of organisation, theme, ability to measure impact and most other dimensions. ■ Every organisation is different and each will have a different type and model of funding that fits them. ■ Social investors are mostly agnostic on the legal form they invest in and would happily invest in social enterprise as well as charity, for example.	Conclusions ■ Special focus needs to be placed on developing case studies, training and mentors to help charities see the possibilities for how best to use social investment. ■ We need to train and develop investors. Recommendation ■ We need to invest in education and, critically with small charities and trustees, build the understanding of possible future business models and how social investment can fund growth in charities to a more sustainable size.
SIFIs ■ Charities understand that banks offer funding and understand how to access this. ■ A large number did not understand the role SIFIs played or the knowledge base they could offer. Charities did not understand the role SIFIs could take in finding access to social investment capital.	Conclusions ■ We need specific training and promotion of the role of SIFIs within the social investment market, their skill base and quality. ■ We need to invest in education around the role of SIFIs and promote their positive impact on this market.
Understanding ■ A consistent understanding of social investment does not exist across the sector. Small charities lack knowledge. ■ We are still in the building phase of the market. ■ Positivity about social investment as a tool increases proportionally with understanding. ■ Charities lack good examples of case studies of social investment they can use. ■ 60% of charities feel positive about social investment. Equally, 40% feel social investment will make no difference to them, and from this 7% are negative towards it. ■ Narrative answers are unequivocal. Over 50% of all responses highlight a strong call for much needed education in finance and social investment.	Conclusions ■ We need to continue to see individual charities as having individual models and needs. ■ We need to continue to build the understanding and possibilities of social investment. This will require good case studies and practical examples. ■ We must continue to see that not every organisation is positive about social investment. Recommendations ■ Special focus needs to be placed on developing case studies, training and mentors to help charities see the possibilities about how best to use social investment and build their understanding. We are still in the building phase of the market. ■ We also need to train and develop investors.

chapter 6:

Report summary

6.1 Framing social investment: charity finance and finance strategy (chapter 3)

The charity sector has seen a reduction in funding from its key income streams (grants, government contracts and donations) in recent years. By all rights, therefore, this should be a sector under pressure as income has reduced and demand for services has increased. Our survey results highlight, however, that charities are not only reasonably confident in their financial strategies but also that they believe that they have appropriate reserves policies. This view is supported by literature that claims the sector is more robust than one might think. However, this is not uniform across the sector and small charities and those funded primarily from grants are feeling most pressure.

Sustainability dominates the mind-set of charities when they think about their funding. Equally, without stability of income streams, charities are unlikely to think of anything else other than sustainability. We have seen that if a charity is positive about their sustainability then this enables them to think more strategically about growth and impact. If a charity is negative about sustainability it inhibits all other thinking.

What is also clear is that charities technically know how to handle grants and donations, but don't necessarily understand how this links to strategic objectives: sustainability, impact, taking work to scale and growth. We need training for the sector on the use of strategic finance to underpin business models.

Our research highlights that many charities don't consider the growth cycle of their work or services and often don't consider the type of funding needed to bring this to life. Funding needs to be structured around a charity's ambition and needs. Specifically, our research shows that while 59 per cent of charities consider sustainability when setting their finance strategy and a similar figure (57%) consider impact, less than half think about the more complex factors related to their business models such as the size of the issue they are addressing, taking work to scale and growth.

“If a charity is positive about their sustainability then this enables them to think more strategically about growth and impact”

For our work focusing on social investment, we observe that even though pressure is growing on charities both financially and in demand for their services, there is inertia regarding change. We also note that social investment will be most successful if it helps organisations with their sustainability and predictable funding.

Our results also show that while some charities feel that their reserve policies are either underfunded or about right, 23 per cent of charities feel their

reserves policy is too safe. These excess reserves could be used to stimulate new funding models and to absorb the risk of innovation.

Another discovery is that FDs will need help to move their focus from primarily financial issues and towards seeing a holistic organisation which has both financial and impact components.

Finally, we see the levels of borrowing already in use in the charity sector. However, in addition to this borrowing, charities *do* want social investment and see their business models changing.

This section has reviewed charity finance strategy and the platform that social investment is to be built on. The following sections look at developing the market and defining social investment.

6.2 What is social investment? (chapter 4)

Social investment is an easy concept to grab hold of, but difficult to clearly define. It uses more ‘commercial-style’ investment tools to fund charities. The report settled on a working definition of social investment:

‘Social investments have the intent and motivation of generating a social or environmental impact as well as financial return on investment. They aim to measure both the social and financial value they create and be held accountable for this.’

Social investment covers a wide range of investment tools from crowd-funding to simple loans and social impact bonds. What matters is that one size does not fit all and each charity will have a type of social investment that suits them best.

Some 71 per cent of charities see social investment as appropriate, but when considering any move towards social investment, a charity will need to revisit its activities and finance strategy to ensure that they can pay back what they have borrowed. However, social investment does not have to be complicated. Small social loans are one of the most powerful investment tools to help growth.

“Charities want money that is affordable ... They want money that will help them become more sustainable, with predictable income streams”

6.3 What do charities actually want from social investment?

By comparing social investment in charities to a similar market – social enterprise – and also by considering the latest academic reports, we identified that charities want two things from social investment:

1. They want money that is affordable. The cost of borrowing is a key factor in the success of the social investment market and its growth
2. They want money that will help them become more sustainable, with predictable income streams. This mirrors our findings from the work on finance strategy and endorses that this is perhaps the best way forward to build demand.

The survey, interviews and seminar series ‘Demystifying the hype’ identified the primary reasons why charities are interested in social investment:

- **Sustainability**, ensuring the ability to diversify income streams in a way that is self-sustaining and predictable
- **Impact**, allowing charities to identify priorities and provide funding linked to these
- **Scaling up and growth**, enabling work to be taken to scale and facilitating greater impact
- **Investing in IT or the low carbon economy** and investing in changing business models to achieve this
- **Autonomy and flexibility in income streams**, rather than needing to dance to the donor’s tune
- **Building their internal infrastructure** to focus on impact measurement.

6.4 What are the different dimensions of social investment?

We have identified **nine key dimensions** to consider when implementing social investment:

1. The business model and funding strategy
2. The culture, mind-set and ethical considerations behind the investment
3. The measurement of social impact
4. The team, capacity and investment-readiness of the charity
5. SIFIs (social investment finance intermediaries) and government commissioners
6. Investment alignment
7. Balancing social ROI vs financial ROI and risk
8. The type of investment
9. Language and terminology.

Our research shows that working together with the investor to define investment motivation and aligning this effectively with that of the charity is critical to build trust. Many charities simply do not realise that different investors have different motivations. Many also feel more relieved when they understand that not all funding comes from mainstream banks.

Better handling and management of data was seen as critical for the future of social investment, as will be the ability to define and measure outcomes.

While we have put forward a nine-dimension model, in reality most investors look at a mix of the social return on investment, the team, the business plans and the financial plans to decide whether to invest or not. Mission-driven investors will typically start with the social return on investment and work through to business plan and financials; banks will typically go the opposite way.

The final finding is the undeniable force of investment that exists. There are trillions of dollars of investment in the world with many different motivations. As grants and donations shrink this will exert a more pronounced ‘gravitational’ force on the charity world.

We are also seeing the birth of a new kind of funder, one who wants to be philanthropic but also seen as a social investor rather than a giver. This opens up opportunities for charities that can align the motivations of investors with their causes.

6.5 Supply and demand of capital: building the market for social investment (chapter 5)

The supply side of social investment continues to build and has reached around £1.5bn capital, according to the latest figure from Big Society Capital's report (Big Society Capital, Social Investment Insight Series, 2016a). The average size of individual investments and loans is coming down, which is meeting the demand for smaller loans from the sector.

On the demand side, our research suggests that 11 per cent more demand for investment and borrowing will arise in the next five years; this is equivalent to £4bn–£6bn capital.

In our survey, all charities see their funding mix moving towards more social investment and borrowing, even those who are negative about social investment. From our interviews and symposium findings, we believe this correlates to the business model being the most important driver of whether or not an organisation would use social investment.

6.6 Survey findings

This is a market in its infancy and we are developing 'market-ready opportunities'. Many investors have raised concerns about the slow growth of the social investment market; we would instead point to the fact that any new market just takes time and effort to build. Compared to the microfinance and green investment markets, we are on a similar growth trajectory and our survey figures show a growth of 26 per cent per annum for the next five years. This is a growing and vibrant market.

Individual charities are in very different places regarding their understanding of social investment – this is highlighted by the broadest spectrum of results in the survey. Understanding is highly correlated to the size of the organisation; smaller charities have less understanding than larger organisations.

In stark contrast to the general trends and positivity about social investment, the survey results show that many charities would not borrow for working capital, fundraising or even for property. Many would not borrow to start a new project or programme. Organisations see their businesses as evolving towards social investment and borrowing, but paradoxically don't understand what they would use the money for.

The key to unlocking the sector's potential to take on social investment lies in the strong correlation found between charities that have a good understanding, and the fact that they feel positive about its use.

Like any new market, building understanding will be vital, along with developing good case studies. We should therefore put our effort into building demand through teaching, lecturing, mentoring and providing good case studies and support. Narrative answers from our survey are unequivocal: **over 50 per cent of all responses highlight a strong call for much-needed education in finance and social investment.**

We look forward to watching and reporting on the progression of this new market as it develops.

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A.2 Signposting and where to go for advice

While there are hundreds of publications, reports and websites on social investment, here are some of the most useful.

- The **Access Foundation for Social Investment** focuses on grants and loans to help build capacity in small charities. <https://access-socialinvestment.org.uk/>
- **Big Society Capital** is the lead organisation for social investment in the UK. Plenty of useful hints, tips and case studies at www.bigsocietycapital.com and on their 'Get Informed' campaign site: <https://www.bigsocietycapital.com/get-informed>
- **Cabinet Office** 'Background note on UK government's approach to social investment'. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/353044/CO_Social_investment_background_one-pager_July_2014.pdf
- **Centre for Charity Effectiveness at Cass Business School**
'Social investment – tools for success: doing the right things and doing them right'. This is a range of guides covering twelve topics including a simple guide on social investment: www.cass.city.ac.uk/cce
- **Centre for Charity Effectiveness at Cass Business School** with research, publications, consultancy and development programmes specialising in social investment. www.cass.city.ac.uk/cce
- **Charity Commission** provides advice on social investment as supplement to CC14: Charities and investment matters. <https://www.gov.uk/government/publications/charities-and-investment-matters-a-guide-for-trustees-cc14>
- **Good Finance** beta website to help improve access to information on investment and finance for charities and social enterprises: www.goodfinance.org.uk/
- **Investing for Good** has some useful information on how investors think, and acts as an intermediary. www.investingforgood.co.uk
- **KnowHow NonProfit**, NCVO's online learning portal, has a useful section on 'What is social investment?' www.knowhownonprofit.org/funding/social-investment-1/what-is-social-investment
- **Social Enterprise UK** is the national body for social enterprise in the UK. www.socialenterprise.org.uk
- **Social Investment Business** provides loans, grants and strategic support to charities and social enterprises to help them change the lives of the people they work with. www.sibgroup.org.uk
- **Social Stock Exchange** provides access to the world's first regulated exchange dedicated to businesses and investors seeking to achieve a positive social and environmental impact through their activities <http://socialstockexchange.com/>



Most of the charities that are
positive about social investment
are those that understand it

Appendix B:

Survey overview and related data set

B.1 Introduction and survey overview

As part of the Symposium we released a survey called ‘Head over Heart the future of charity finance’ (2015) focused on three themes:

- **Theme 1:** The strategic role of finance in a charity
- **Theme 2:** How well do charities measure non-financial information and specifically outputs, outcomes and impact?
- **Theme 3:** What are the component parts of social investment, including the positive forces and barriers, and how positive do charities feel about social investment as a new tool within this framework?

The survey was developed by Cass CCE, and checked for flow and bias by Big Society Capital, Charity Finance Group and Charities Aid Foundation (CAF).

We received 192 responses to the survey, which took about 25 minutes to complete, and 151 of these were answered completely from end to end with narrative answers to back up responses.

While the survey was a little longer than normal, it provided us with the opportunity to understand the responses on charity finance, and give context for the responses on social investment.

This survey represents only a small number of the approximately 160,000 charities in the UK, but it suffices to detect trends and draw indicative conclusions. It also allows us to identify further areas of research.

Survey respondents

The responses to the first section of the survey provide an overview of the sample characteristics of respondents and an understanding of the extent to which the findings of this survey can be generalised to the wider population of nonprofit organisations.

Q1 What type of organisation do you work for?

Figure B1: Respondent organisations

TYPE OF ORGANISATION	NUMBER
Charity	127
Foundations and trusts	12
Advisors	12

- We had 192 responses of which 151 were complete.
- The incomplete responses were excluded. We also excluded responses from those who identified themselves as from foundations, trusts and advisors.
- Our quantitative data analysis is therefore based on 127 full charity responses.

Q2 What sector does your organisation work in?

The table below presents the list of sectors represented, as well as the number of respondents who identified with each area.

The breakdown shows that the survey managed to capture respondents working across a broad spectrum (Figure B2). For the purpose of this research, this broad range is seen as a positive as it confirms the sample is not overly represented by any particular area.

Figure B2: Respondent sectors

SECTOR	COUNT	% OF RESPONDENTS
Arts and culture	6	5%
Children and young people	15	12%
Disability	8	6%
Education	13	10%
Elderly	5	4%
Healthcare	23	18%
Infrastructure	12	9%
INGO	18	14%
Religion	8	6%
Other	19	16%

Overall, the small number of respondents identifying with each individual area means that conclusions can only be drawn in general rather than being specific to a sector.

Q3 Your organisation's annual turnover (approx. in £)

For the purpose of this research, turnover was used as an indicator of size. Definitions of small, medium, large and major charities are given below.

Figure B3 presents the size categories and the number of respondent organisations falling into each category both as numbers and percentage of the whole. The respondents are split between the categories with the majority being large charities.

Figure B3: Size of respondent charities

ANNUAL TURNOVER (approx. in £) (income)	CATEGORY	COUNT	%
<100,000	Small	13	10%
<1,000,000	Medium	33	26%
<10,000,000	Large	53	42%
>10,000,000	Major	28	22%
	Total	127	100%

The voluntary sector is dominated by small organisations with a turnover of less than £100,000 (NCVO, 2015b). Over 80 per cent of charities have a turnover of less than £100,000. Our data therefore does not represent the entire sector, but instead capture a picture of balance within different sizes of organisation. The sample is clearly biased towards larger organisations

against the entire sector and therefore likely to represent those organisations with better resource capacity, systems and infrastructure.

Q4 Your role

The survey allowed any respondent to answer, so respondents may not necessarily be credible or in positions of responsibility or influence. We were concerned that data could be at risk of contamination by uninformed responses as a result of insufficient knowledge or experience.

Figure B4: Respondents' role

ROLE	COUNT	%
Finance director	46	36%
CEO	27	21%
Director (other)	24	19%
Chair, trustee or other board member	22	18%
Other	8	6%
Total	127	100%

From this high-level analysis (Figure B4), it can be seen that the 94 per cent of respondents are in credible and appropriate positions within their organisations. This provides a measure of confidence that the majority of respondents have the necessary knowledge and understanding to answer survey questions with reasonable accuracy.

Respondents who identified themselves as Finance directors were the most numerous at 36 per cent, with a fair balance of CEOs (21%) and trustees (18%) responding.

Q5 What percentage of your income is through 'grants and contracts', 'philanthropy and donations' and 'social enterprise'?

The final general question aimed to get an overview of the funding mechanisms at play within our sample of respondents.

Figure B5 presents an analysis of the percentage of income derived from grants and contracts, philanthropy and donations and social enterprise. On average, grants and contracts make up the largest portion of income of the respondent organisations at 47 per cent of the total income. On average, 32 per cent of income is derived from philanthropy and donations, and social enterprise makes up the smallest proportion of the three sources of income at 12 per cent.

Figure B5: Composition of finance for respondents



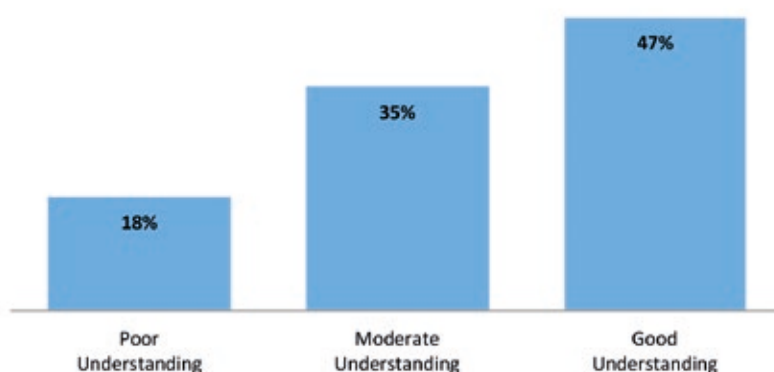
The analysis indicates that on average our sample of organisations demonstrates a strong reliance on grants and contracts. However, in the sector as a whole, charities tend to have a funding mix of 33 per cent grants and contracts to 47 per cent donations and philanthropy – exactly the reverse of our respondent sample (see [section 3.1](#) for more details).

Given the sharp decline in government funding since its peak in 2009/2010, this funding mix suggests that charities in our survey will be experiencing similar finance pressures to others in the sector who are focused primarily on government grant and contract funding, and this is why they are perhaps looking for tools such as social investment to help them. This could be a potential bias to our survey, but is not considered too skewed to make the results of our survey invalid.

Q6 What is your personal understanding of investment and borrowing?

Nearly 50 per cent of respondents claimed they had a good personal understanding of investment and borrowing ([Figure B6](#)). Only 18 per cent felt they had a poor understanding. This is potentially positive, indicating that most respondents would be knowledgeable when answering further questions.

Figure B6: Personal understanding of social investment and borrowing



However, a respondent's knowledge could indicate that they self-selected to answer the survey. It cannot therefore be assumed to be representative of the sector in general. This bias needs to be considered in the analysis of the results.

B.2 Questions on the strategic role of finance in charities

To understand the nature of the strategic role of finance in a charity we asked two sets of questions. The first questions were focused on whether respondents felt confident in the long-term finance strategy of their organisations, and narrative responses accompanied this. We also asked what they felt about the appropriateness of their reserves policy.

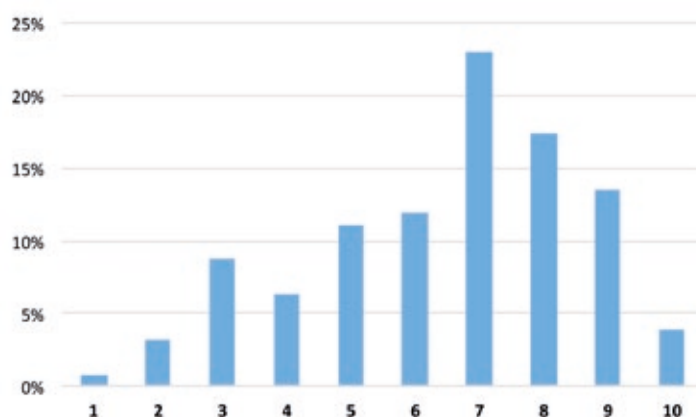
The second set of questions considered what organisations consider when they set financial strategy:

- Sustainability
- Impact
- The size of the issue that is being focused on
- Taking their work to scale and growth.

Q7 How confident do you feel in your organisation's long-term financial strategy?

On the whole, survey respondents felt confident in their long-term financial strategy, as shown in [Figure B7](#).

Figure B7: Confidence in long-term financial strategy

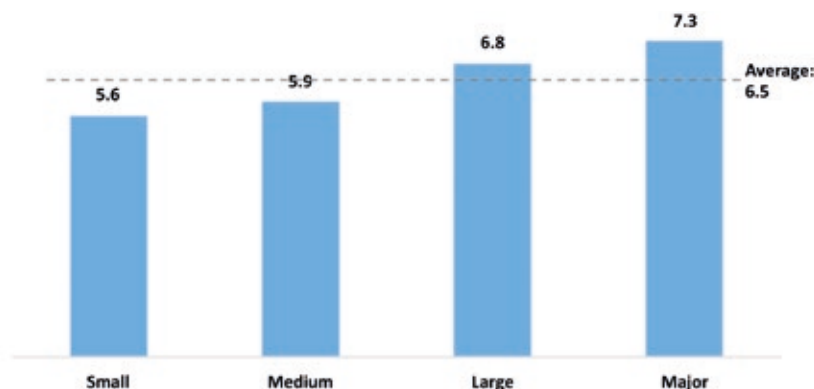


Scale 1–10 (1 = Not Very, 10 = Very). Average: 6.5. Median: 7.0

Given the pressure on charity finances highlighted in [section 3.1](#) from falling donations and government funding, it would be reasonable to suggest that respondents may not feel very confident in their long-term financial strategy. It was surprising, therefore, that our analysis reveals that respondents felt reasonably confident, with an average score of 6.5 and median of 7.0. This is an important finding, one that supports research findings from Chapman and Robinson's 2013 report *On the money*, which reports that the charity sector as a whole is perhaps considerably more stable and resilient than might be imagined.

Further analysis of the data reveals a clear trend between the size of the organisation and the level of confidence reported. With the caveat that our sample under-represents small organisations and over-represents large and major organisations, this analysis suggests a strong correlation between size and confidence ([Figure B8](#)). The larger the organisation the more confident it will be in its long-term financial strategy.

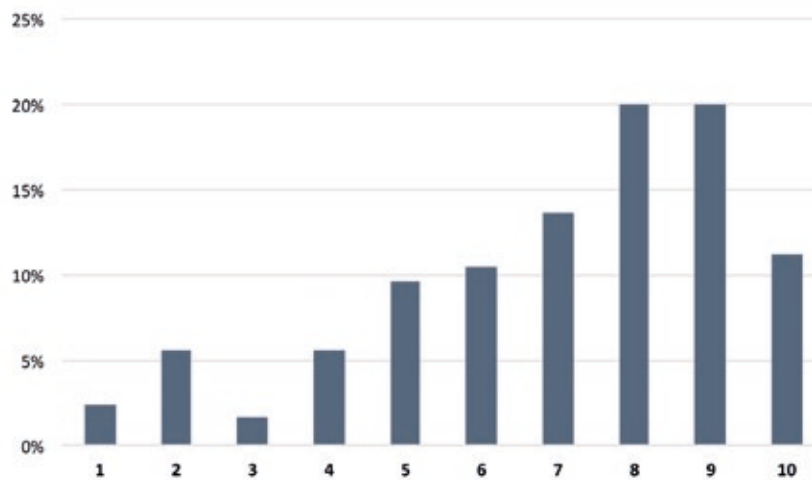
Figure B8: Showing correlation of size of organisation to confidence in long-term financial strategy



Q8 How appropriate is your reserves policy?

Charities who responded to the survey felt that on average their reserves policy was appropriate, as demonstrated in [Figure B9](#).

Figure B9: Appropriateness of reserves policy



Scale 1–10 (1 = Not Very, 10 = Very). Average: 7.0. Median: 8.0

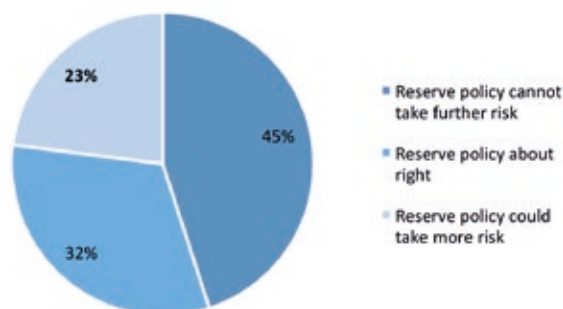
Again we saw a similar trend towards larger charities having more confidence in their reserve policy, and it was mainly small charities that had negativity towards this question.

Q9 To what extent do you feel that your organisation's reserves policy is too risk averse?

The question on risk aversion highlights that charities felt on average that their reserves policies were not too risk averse. But unlike the appropriateness of reserves policy, this was not correlated with the size of the charity.

While there was a broad spread of answers, with many feeling that there was no scope for flexibility, around 23 per cent felt that their reserves policy was too risk averse, in some cases strongly so ([Figure B10](#)).

Figure B10: Is your reserves policy too risk averse?



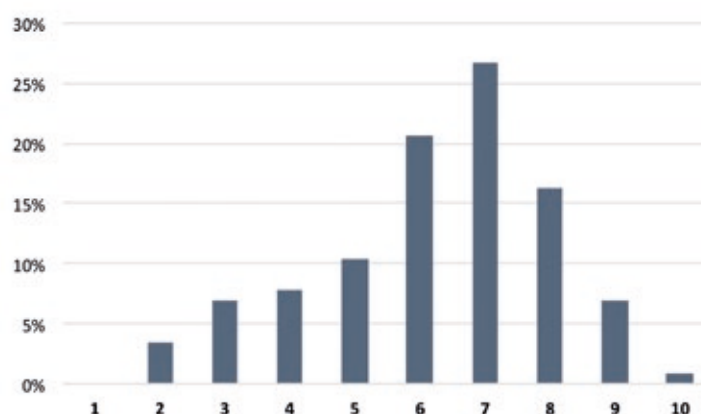
There is a potential opportunity for some charities to take greater risks with reserves and try new models of business. This is effective risk capital that they could use for more impact-focused work. The results of our survey can only be indicative, but point to further research needed in this area to understand reserves policies and risk-taking attitudes.

Q10 Flexibility of funding models and reserves

We asked two further questions to better understand the nature of funding models and reserves:

- How would you rate the stability of your organisation's income stream?
- To what extent would you describe your organisation as having high fixed/committed costs?

Figure B11: Perceived stability of income stream and level of fixed costs within respondent charities

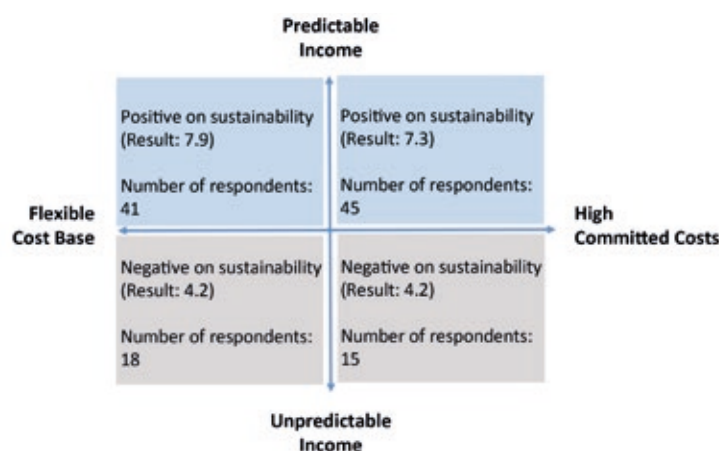


Scale 1–10 (1 = Not Very, 10 = Very). Average: 6.2. Median: 7.0

Figure B11 shows that, on average, respondents believe they have stable income streams.

The report *Beyond reserves* (ACEVO, CFG, Sayer Vincent, 2012) takes a detailed look at reserves and divides organisations' behaviour in managing reserves according to whether or not they have predictable income and/or a stable or flexible cost base. **Figure B12** uses this framework and determines the level of long-term financial sustainability in each case from respondents using our survey data.

Figure B12: Sustainability of organisations against different forms of organisational cost and income



Our survey shows that sustainability is highly correlated with whether or not organisations can predict their income. Where organisations cannot, they rank themselves significantly lower in terms of sustainability than those with predictable income.

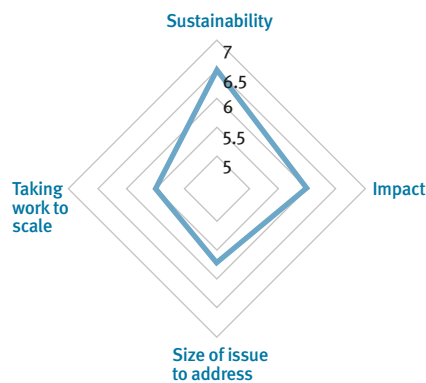
This is a critical finding for our work on social investment. It shows that organisations need stable income streams to have long-term financial sustainability. Therefore, social investment is most likely to be seen as favourable if it creates predictable income streams.

Q11 What do you think about when you set your finance strategy?

We asked whether charities, when setting their financial strategy, thought about sustainability, impact, the size of the issue or taking work to scale.

Responses from our survey showed: **organisations across the sample thought first and foremost about sustainability when setting their financial strategy along with the impact they create. They think less about taking their work to scale and the size of issues** (see Figure 5 in section 3.2 and Figure B13).

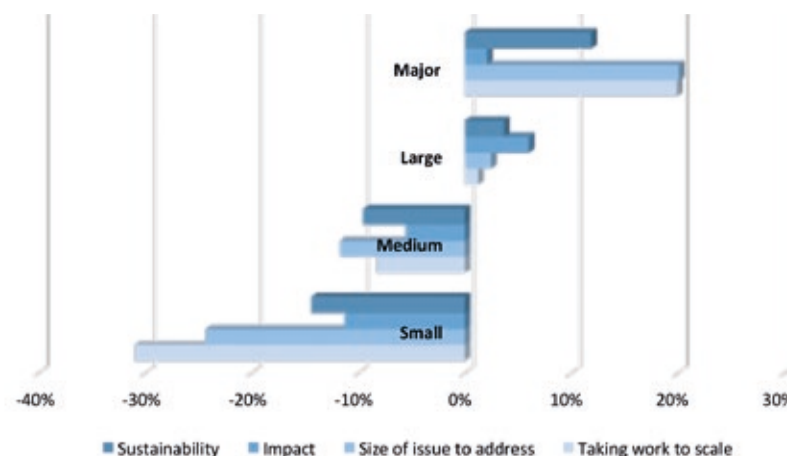
Figure B13: What do charities think about when setting their financial strategy?



Scale 1–10 (1 = Don't think about this, 10 = Think about this in detail).

Furthermore, the data showed a very strong correlation between the size of the organisation and their ability to think about sustainability, impact and taking work to scale (Figure B14).

Figure B14: What do charities think about when setting their financial strategy versus size of organisation? (variance against average %)



Small charities consider survival first and foremost during financial planning. They consider how to grow much less.

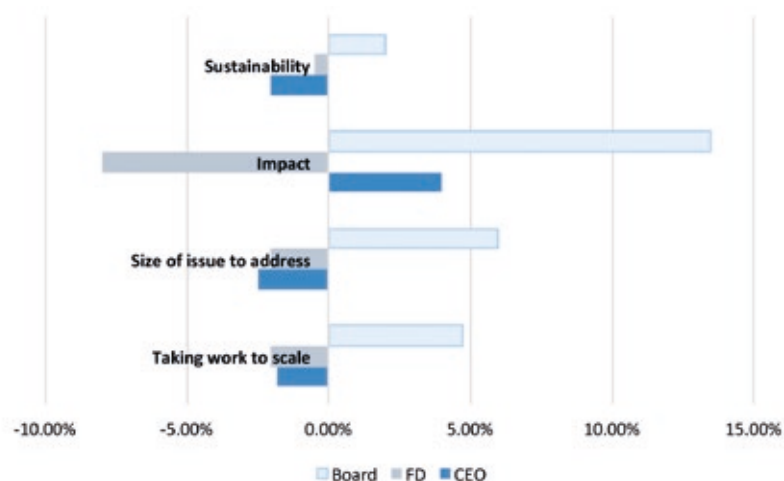
It is possible that large and major organisations enjoy superior capabilities to navigate the evolving operating and funding environment experienced by the sector, which may go some way to explaining the overall confidence exhibited in this sample.

Small organisations need capacity-building help to enable them to think more broadly about their finance strategy and how it can help them. This will help them develop business models that they can take to scale and give them more confidence in their sustainability.

Q12 Did any group of respondents have distinctly different views about setting financial strategy?

Our results from the survey showed that in general the board of trustees was positive in considering all areas of charity finance (Figure B15). They were more positive than both the CEO and FD. The FD was most negative about impact. In contrast, however, the board is most negative about social investment – a powerful observation (see Q26 in Appendix B and Dimension 4 on page 38).

Figure B15: Analysis on how different parties think when setting financial strategy (CEO, Board and FD)



This result highlights that charity FDs will need to develop an understanding of impact to prise them away from thinking about financials alone. In other words, charity FDs need to start to think more holistically and consider both finance and impact together for the future financial strategy of the organisation.

Q13 Is there a link between charity funding and how positive charities are about their long-term financial strategy?

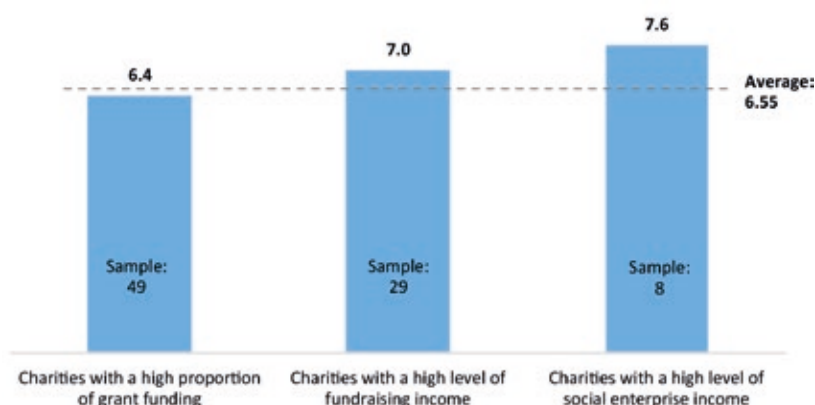
We used the data from the survey to look for correlations between the predominant funding mechanism for a charity and how they see their long-term financial sustainability.

While sample sizes were small, especially for those funded mainly by social enterprise, the indicative results are clear that those charities funded by grants are less positive on their long-term financial strategy than those funded mainly by fundraising and those funded mainly from social enterprise.

Results indicated that those most positive about their long-term financial sustainability were funded mainly through social enterprise (Figure B16).

This is a critical finding, as organisations that use a social enterprise model see themselves as having long-term financial viability while enjoying a certain independence from government or donor requirements.

Figure B16: Predominant funding type versus view on long-term financial sustainability



Many large organisations operate successfully and sustainably with models based on grants, contracts or fundraising income. This is not in debate. However social enterprise offers a different model and has a stronger correlation with respondents feeling confident that they are financially sustainable in the long-term. As funding cuts lead to more financial pressure on charities this could be a direction that many charities look towards to ensure their future.

Q14 Narrative questions

Following the previous questions, the survey provided respondents the opportunity to add in narrative to give more insightful explanations of why they felt confident or uncertain about their organisation's financial sustainability.

Top three reasons for confidence

1. Good planning and diversified income streams
2. Large reserves and/or substantial endowments
3. A good commercial model

None of these reasons are particularly unexpected, apart from comments about good commercial models. Notably, the following quote was echoed by some:

'By creating revenue routes through commercial operations, our organisation is less dependent on funding from grants.'

Respondents pointed to the quality of staff as critical in moving towards a more commercial funding model and the need to have people in the organisation with experience of having done this before.

Top three reasons for uncertainty

1. Dependent on grants and contracts
2. Dependent on donations
3. Political uncertainty

The predominant reason for uncertainty indicated by respondents is a dependency on grants and government contracts. One quote summed up the situation:

‘Over-reliance on contract and grant funding together with annual contract extensions has led to our charity becoming very inward-focused.’

Dependency on grants and donations, uncertainty of future income and political uncertainty are all interrelated factors that when taken together substantiate the claim that the funding environment in which charities operate has drastically changed. Apprehension relating to the risk of further reduction in government funding of the sector was clearly outlined, representing a key factor causing uncertainty amongst the organisations surveyed.

There is still a major concern regarding the conclusion of the government spending review and what the fallout may be for local authorities and their budgets.

The top three reasons for uncertainty point towards a need to move the sector towards a more diversified funding mix. This supports commentators who stress the need to diversify income away from traditional forms of funding typically seen in the sector.

Many advocates of social investment argue that it is in this state of pressure and vulnerability that repayable finance has the potential to help.

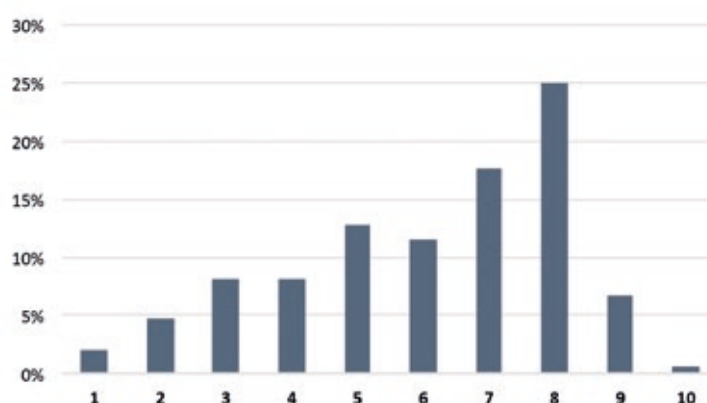
B.3 Questions on a charity’s ability to measure non-financials

Using our survey results we were able to plot the ability of charities to measure outputs, outcomes and impact. We also asked how well charities could measure non-financial measures in general as a comparator and to sense-check responses.

Q15 How well does your organisation measure non-financial performance?

Figure B17 highlights that on average **charities were confident** in their ability to measure non-financial information.

Figure B17: How well does your charity measure non-financial information?



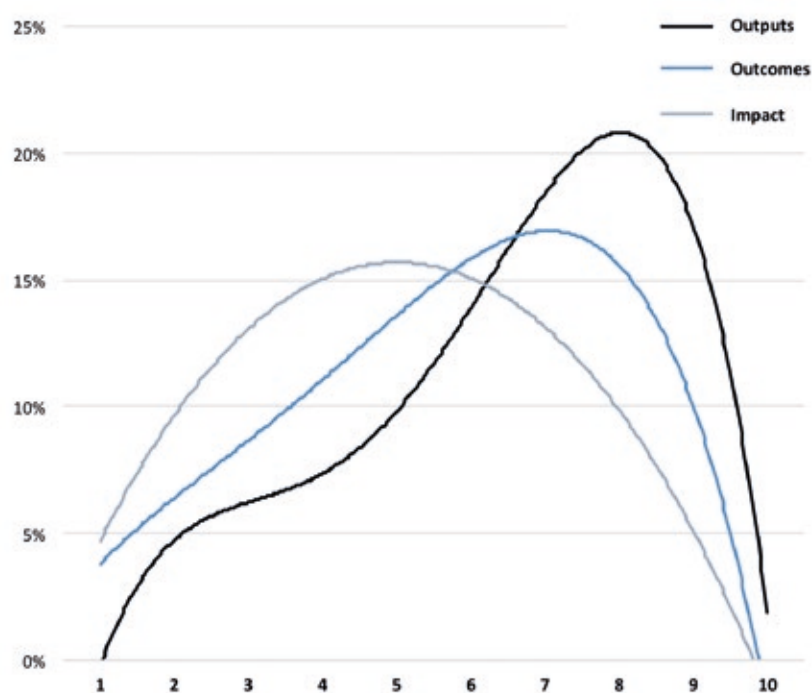
Scale 1–10 (1 = Poorly, 10 = Very well). Average: 6.1. Median: 7.0

However, the results were strongly correlated with the size of the organisation, with smaller charities less able to successfully measure non-financial information. This again points to the need to develop capacity in smaller organisations.

Q16 How well does your organisation measure outputs, outcomes and impact?

The results indicated different levels of confidence in ability to measure outputs, outcomes and impact (Figure B18).

Figure B18: Ability of charities to measure outputs, outcomes and impact



Scale 1–10 (1 = Poorly, 10 = Very well). Outputs average: 6.6; median: 7.0. Outcomes average: 5.6; median: 6.0. Impact average: 4.8; median: 5.0.

In each case results are correlated strongly with the size of the organisation, with small charities considerably less able to measure outputs, outcomes and impact than medium, large and major organisations (Figure B19).

Figure B19: Size of organisation and ability to measure outputs, outcomes and impact (average)

SIZE	NON-FINANCIAL	OUTPUTS	OUTCOMES	IMPACT
Small	4.4	5.2	4.1	3.7
Medium	6.2	6.2	6.1	5.0
Large	6.2	7.0	5.6	5.0
Major	6.2	7.2	5.4	5.0

The results show that, overall, the sector appears to be capable of measuring non-financial information, but this is focused on activity and output levels. Outcomes are less easily measured and measuring impact continues to be an issue. Complicated models such as SROI were specifically highlighted as examples of tools that organisations needed support for in order to use effectively.

Q17 Narrative response

The narrative responses were wide and varied and highlight the need to do further work in this area. Responses consistently talked about the overlap of donor requirements as a key issue and the need for more to be done on data collection across organisations focused on the same themes and their funders, in order to coordinate resource, research and effort.

Comments indicative of the whole were:

- *'It has been a challenge creating outputs, outcomes and impact at organisational level and these have largely been set at programme level and often with significant input from the funders. It can be expensive to do the amount of monitoring we'd like so sometimes that can be a barrier too.'*
- *'This is our biggest challenge. Until recently we generated a very high proportion of income ourselves or via donations so we were not required by external organisations to measure impact etc. As the organisation has more than doubled in size in the past year, we have had to start fundraising from trusts/foundations and have now turned our attention to measuring impact.'*
- *'Partly there is real confusion about what each terms [sic] [outputs/outcomes/impact] means as different funders, whose requirement generally often drive the evaluation process, use them differently so it's difficult for the organisation internally to have a clear consistent idea of what they mean. Also our board find it difficult to have clarity around this issue and therefore to give sufficient time and energy to assessing around it.'*

The top three issues with measuring outputs, outcomes and impact

1. The difficulty in defining and measuring long-term impact
2. Lack of resources (time and cost)
3. Difficulty collecting and interpreting data.

Clearly more training is needed in this area. It would also be helpful for more common measures to be shared and coordinated across charities. Equally, donors should realise that measurement is expensive and should be prepared to pay for this service. This area requires considerable further unpacking and paves the way for future research work.

B.4 Questions on social investment

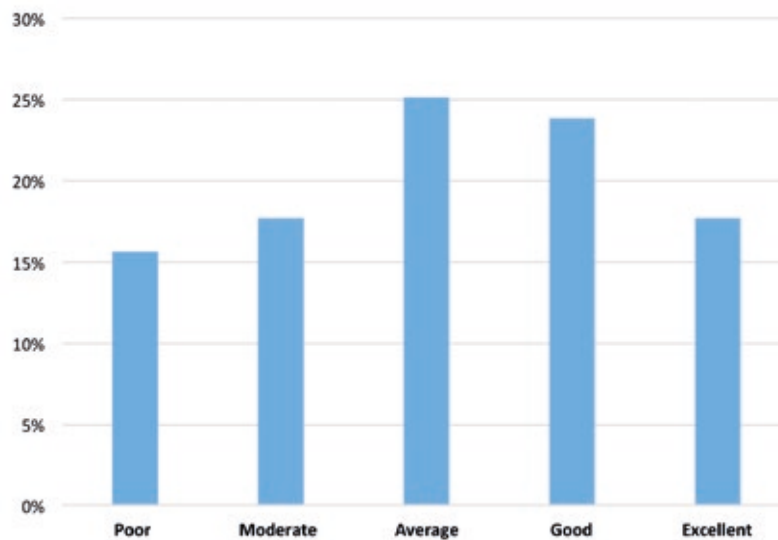
The final section of our survey looked at social investment and considered

- the current understanding of social investment within charities
- the skills available to make use of social investment as a tool
- whether organisations would potentially borrow and if so what for
- what the barriers to borrowing are
- how much social investment will change charity's business models in future away from grants, contracts and fundraising.

Q18 To what extent does your organisation understand what social investment is?

Whilst there is no absolute definition of social investment, there is evidence to suggest that ambiguity around the term has negatively affected the progress of the market to date. The survey recognised this uncertainty over definitions and asked respondents to what extent they felt their organisations had an understanding of social investment.

Figure B20: Level of understanding of social investment within your organisation

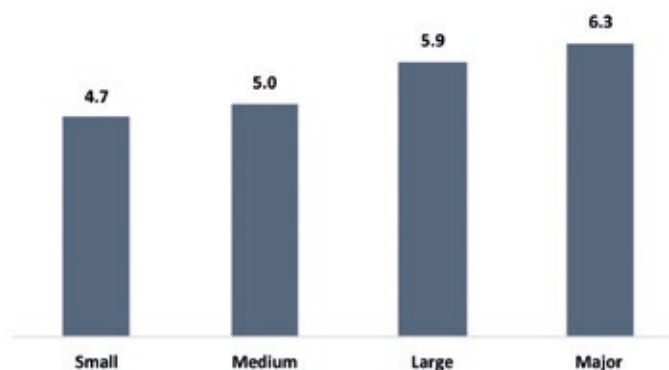


The wide range of responses highlights the spread of both individuals and organisations on the path to understanding and implementing social investment (Figure B20).

Those who identified that a good proportion of their income came from social enterprise had by far the best understanding of social investment.

For greater insight, an analysis was undertaken breaking down understanding of social investment by the size of the organisation. The results reveal a clear trend between the size of the organisation and the level of understanding of the respondent. Understanding of social investment is significantly greater amongst the larger charities, with the weakest level of understanding exhibited amongst the smallest organisations (Figure B21).

Figure B21: Average level of understanding of social investment (by size of organisation)



There has been growing acknowledgement that one of the key barriers to securing repayable finance is the issue of investment readiness. Part of the problem of being investment ready may lie in the confusion over what social investment is and this research points to this problem being particularly pronounced within smaller organisations, which make up the majority of charities.

This trend suggests that the provision of information and guidance needs to be directed towards smaller and medium-sized organisations that exhibit a poorer understanding of social investment.

Q19 How do you see your finance mix between grants and donations or borrowing and investment now and in five years' time?

We asked respondents to consider how much they felt their business models would move away from grants and donations towards borrowing and investment within five years.

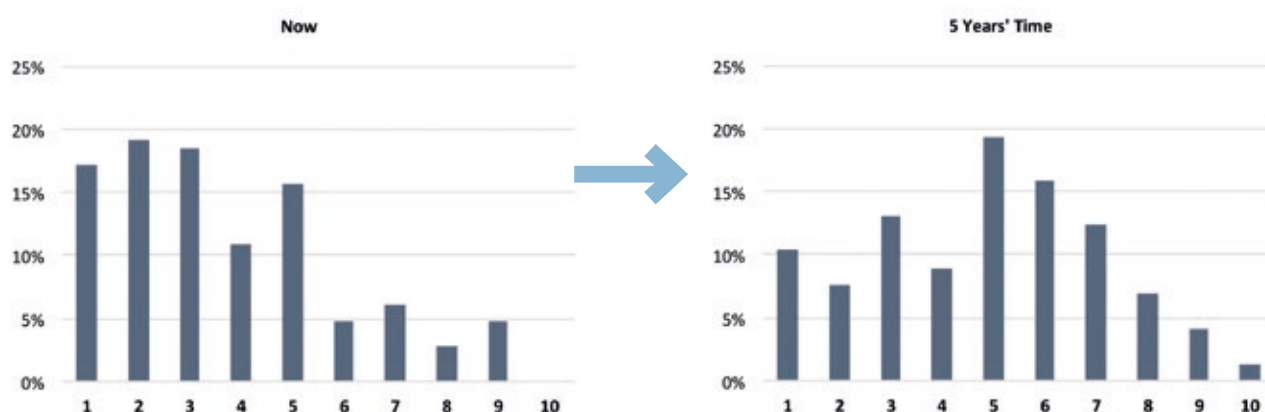
All charities saw their funding mix moving toward more investment and borrowing, even those who were negative about social investment. Both small and large charities saw significant changes (Figure B22).

Figure B22: The shift towards investment and borrowing (by organisation size)

INGOs suggested a 23 per cent shift in their funding models toward borrowing, which potentially indicates the greatest opportunity for social investment.

SIZE	% SHIFT
Small	10%
Medium	10%
Large	13%
Major	14%
Overall	11%

Figure B23: How do you see your finance mix between grants & donations and investment & borrowing now and in five years' time?

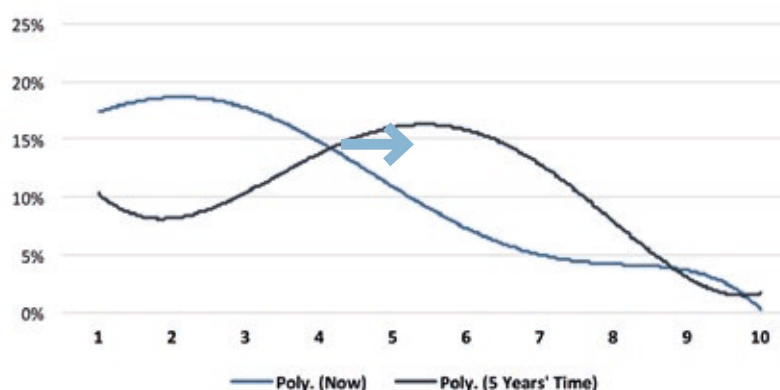


Scale 1–10 (1 = Grants & donations exclusively, 10 = Investment & borrowing exclusively)

While there was a positive shift across almost all organisations, the responses did not appear to be correlated on the ability to measure impact, nor to any degree on the type of organisation or the theme it focus on. **From our interviews and symposium findings, we believe this correlates to the business model being the most important driver of whether an organisation would use social investment or not. Business models are everything.**

The average score of responses over the five years shifts substantially from 3.577 to 4.799 (Figure B23 and Figure B24). The results show that respondents were aware and acknowledged that borrowing and investment played a limited role within the organisation's financial strategy today, but this could change in future.

Figure B24: How do you see your finance mix between grants & donations and investment & borrowing now and in five years' time? (same data as Figure B23 shown as smooth curves)



Scale 1–10 (1 = Grants & donations, 10 = Investment & borrowing growth).
Total count: 127. Data now average: 3.577. Data 5 years' time average: 4.799.

The analysis suggests that respondents see borrowing and investment playing a larger role in their financial strategy in the future. This finding directly challenges the results of previous research, which found the majority of organisations were simply not interested in borrowing or social investment. This research sees a growing willingness from charities to consider repayable finance as part of their financial strategy.

It can be deduced that organisations continue to see grants and donations as their primary forms of funding; with the expectation that the funding mix will move toward investment and borrowing, however, social investment might provide a new tool which can be used to fund their ambitions.

So how does this translate to the growth of the social investment market in the next five years?

Against the total sector income of £43.8bn (NCVO Almanac, 2015b) our findings suggest that 10–14 per cent (average 11 per cent) more demand for investment and borrowing will happen in the next five years; this is equivalent to £4bn–£6bn capital with an expected value of £4.8bn.

Those who receive their funding primarily from grants saw their models shifting more towards investment and borrowing (Figure B25). This could be explained by the pressure to find new funding models given the severe recent cut backs in government funding.

Figure B25: The shift towards investment and borrowing

SOURCE	SHIFT %
Mainly funded from grants	16%
Mainly funded from fundraising	9%
Mainly funded from social enterprise	11%

Similarly those respondents who said their organisations lacked reserves were most positive about shifting toward investment and borrowing and therefore being open to social investment opportunities. These last two comments could be indicative of viewing social investment through 'rose-coloured spectacles' as this could be seen by certain organisations as

potentially a way out of immediate funding difficulties. This deserves further exploration.

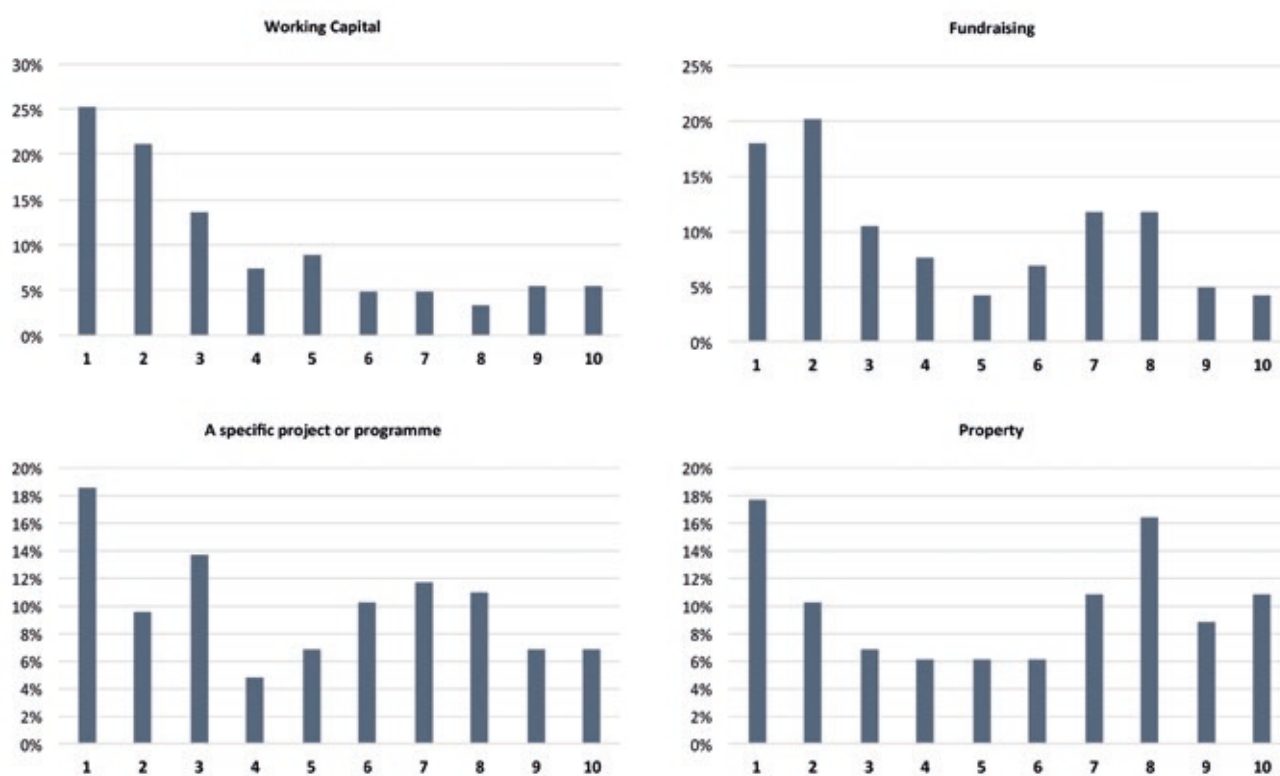
In summary, nearly all respondents expected to see a shift in funding mix toward investment and therefore the potential for social investment as a new tool.

Q20 What would you borrow for?

We asked organisations what they would borrow for. In stark contrast to the positive thoughts about social investment in the previous question, the results showed that many would not borrow for cashflow, fundraising or even for property (Figure B26). Equally many would not borrow to start a new project or programme.

Building on the previous response, organisations see their businesses as evolving towards social investment and borrowing to fill a funding gap, but don't have a common purpose for which they would use the investment.

Figure B26: What would you borrow for?



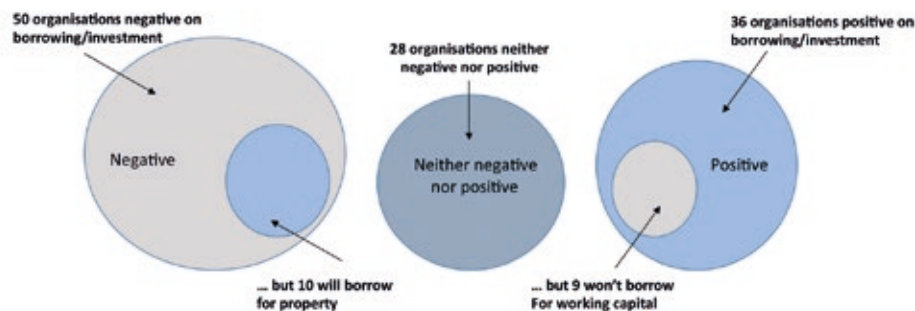
Scale 1–10 (1 = Won't borrow, 10 = Will borrow).

We conclude that each organisation is unique in its motivation for borrowing.

Looking deeper into the data helps us to understand the dynamic behind responses. Specifically, many respondents said that they would not borrow for anything, while others said they would use social investment and borrowing if it suited their purposes.

Respondents often appeared black and white in their mind-set. Some who were negative would borrow for property. Equally, others who were positive towards borrowing would not consider doing so for cashflow purposes (Figure B27). This mixed picture is again indicative of the motivation for borrowing and investment being specific to each individual organisation.

Figure B27: What organisations would borrow for – further breakdown of responses

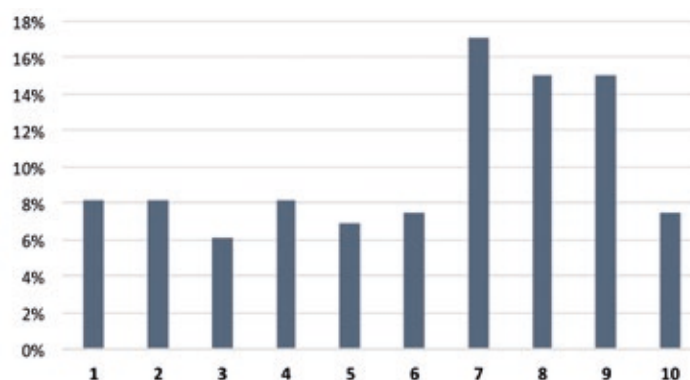


Finally, it is worth noting that many commercial SMEs (small and medium enterprises) will not borrow or use investment, instead relying on organic growth. It would therefore be wrong to assume that all charities will use investment and borrowing in future.

Q21 Would you know where to go to get funding?

Some 60 per cent of respondents said they knew where to get funding (Figure B28). The responses appeared to correlate with the size of organisation, with small organisations being less likely to know where to go. Grant funders like the new Access fund understand this and have started to focus on the small end of the market with ‘blended capital’ – a mixture of grant and loan.

Figure B28: Would you know where to go to get funding?



Scale 1–10 (1 = Would not know where to go, 10 = Would know where to go with certainty). Average: 6.1. Median: 7.0.

Q22 What would you borrow for and from where? (Narrative responses)

An analysis of narrative responses shows that charities would mainly borrow to buy a property (39%) and over half of these would seek finance from a bank or traditional lender to do this (Figure B29 and Figure B30). This is not surprising given that high street lenders are the key provider of mortgage products.

Figure B29: Why would your organisation consider borrowing (narrative)?

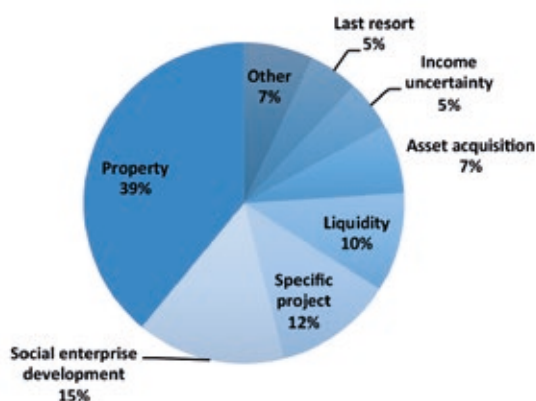


Figure B30: Where would you borrow from (narrative)?



These findings substantiate the claim that large quantities of capital that are not captured by the term ‘social investment’ are already being harnessed in the social sector. NCVO Almanac (2015b) reported that the voluntary sector in 2012/13 owed approximately £3.5bn in loans.

The ethics of the lender were deemed of *some* importance (47 per cent of respondents) whereas 80 per cent of respondents stated interest rates were *very* important when considering loans. These findings raise real challenges for social investment. If the charity sector is already harnessing a significant amount of external finance, how can the social investors best satisfy demand that is not already being fulfilled by commercial lenders? In addition, if charities consider interest rates significantly more important than the ethics of the lender, social investment as a concept may not be able to rely simply on the motivation of the investor and the expected impact of the investee. Instead, the commercial attractiveness of the finance on offer may be a priority.

One respondent noted: *‘Borrowing is expensive, especially from ‘social’ lenders who want a normal (or higher) financial return plus a social return.’*

However, research and further interviews point to ethics being a key concern for some in the sector. One respondent saw the need for *‘social capital for the social sector, which understands impact and stands alone’*.

The conversation about how social investors show their added value will be critical to create a vibrant and energetic sector, and is not one predicated solely on the cheapness of capital.

Our interviews would suggest that organisations would inherently know to go to a bank, but would not be aware of the range and scope of social investors and SIFIs (social investment finance intermediaries) available.

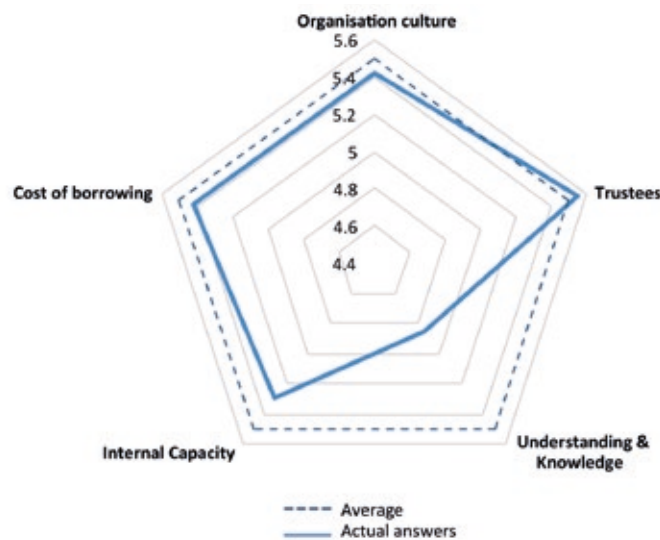
Q23 What are the key barriers to taking on borrowing and social investment?

The explorations in our ‘Demystifying the hype’ seminar series identified this list of key barriers:

- Understanding and knowledge
- Trustees
- Internal capacity
- Cost of borrowing
- Organisational culture.

Within the survey the respondents confirmed each barrier as an issue and these will need to be addressed as we move forward with our social investment journey (Figure B31). However, respondents identified that **the key barrier was understanding and knowledge about social investment.**

Figure B31: Key barriers to social investment



Scale 1–10 (1 = A significant barrier, 10 = No barrier).

If organisations understand social investment then they are most likely to use and think positively about it (+20%) and if they don’t understand they are least likely to use it and will think more negatively (-24%).

Q24 What are the biggest internal and external barriers to raising finance? (Narrative)

For the purpose of analysis, ‘internal’ is interpreted as barriers relating to limitation and problems experienced by the organisation *itself*, in attempting to take on social investment. ‘External’ barriers are defined as those concerning the nature of supply of social investment. The key barriers identified in narrative responses are shown in Figure B32.

Figure B32: Internal and external barriers to raising finance

INTERNAL BARRIERS	EXTERNAL BARRIERS
1. Ability to repay/generate income/ lack of commercial potential	1. Raising finance is expensive
2. Knowledge and understanding	2. Willingness of lenders
3. Culture	3. Long and arduous process

The most significant external barrier to raising finance is that it is perceived as being too expensive: *'We have no assets to borrow against, therefore our risk profile is high and borrowing is expensive.'*

A number of respondents reported finding social investment to be more expensive than commercial options: *'Social finance appears to be considerably more expensive than commercial finance. Also, barriers are created throughout the process, which means that what should be a three-week application turns into a nine-month nightmare!'*

This quote also captures the long and arduous process with which many respondents find themselves struggling when considering social investment. Respondents described extensively the internal barriers and particularly their concerns about their ability to repay the investment. Of course, an organisation's ability to repay is directly linked with how expensive the finance is, but a number of respondents expressed their concern over their organisation's lack of commercial potential. Many respondents felt a commercial model was simply unattainable given the nature of their work.

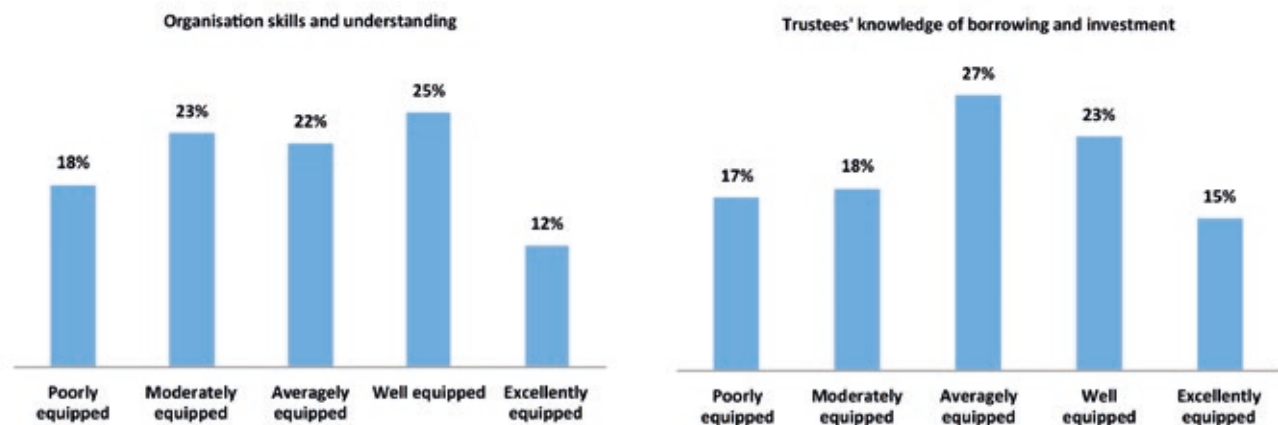
Whilst trustees and management have little experience of operating within an environment where borrowing is the norm, they recognise that this is likely to become increasingly important in a competitive funding environment. However, most organisations within the nonprofit sector are likely to struggle with servicing the cost of finance within current business models.

Our work points to the potential and desire for social investment to change business models for organisations. However, we must overcome barriers to get there, in particular designing new business models in which charities can pay back capital borrowed. This will require organisations to move away from their main funding mechanisms of grants and donations.

Q25 How well equipped are your organisation and trustees with the skills and knowledge to take forward social investment?

There was a very diverse range of answers as to how well equipped respondents felt their organisations and trustees were to take forward social investment. **Responses showed that each organisation would need something different to help them on the journey towards social investment.** Again, smaller organisations need more help with skills and knowledge compared with larger organisations.

Figure B33: How well are organisations and trustees equipped with the skills and knowledge to take forward social investment?



Those that are well-equipped tend to be those that are better at measuring non-financials and impact. Unsurprisingly, social enterprise-funded organisations also see themselves as well equipped. Potentially we could learn from social enterprises and establish some mentoring schemes or partnering arrangements to transfer knowledge into the sector.

Narrative responses to this question highlight three key needs:

- 38 responses highlight a strong call for much-needed education in finance and social finance specifically
- 14 respondents highlight the cultural shift that trustees will need to go through to move them away from their existing funding models based on grants and donations
- 12 respondents wanted case studies and good practical guidance

Typical of quotes was this:

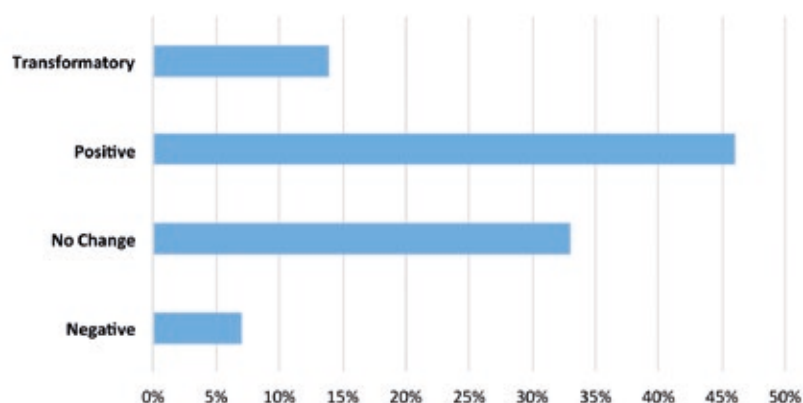
'There is a lot of talk about social investment but not much practical, hands-on support. The social investment bandwagon is asking charities to jump too far without providing a bridge of practical support.'

Initiatives such as the Big Society Capital 'Get informed' campaign to help trustees understand social investment are welcomed and will be critical if demand is to grow.

Q26 How positive do you feel towards social investment and borrowing to leverage your organisation's work?

The final question is the key question to unlocking the sector's potential to take on social investment. It is interesting to note that there is a wide range of opinions on social investment and borrowing and this is reflected in the respondents' views.

Figure B34: How positive do you feel about social investment and borrowing?



Some 40 per cent of charities feel that social investment will bring little or no change to their organisations or are openly negative about it. However, 60 per cent see social investment and borrowing as either positively changing their business models or being transformational to them.

Cross-referencing this knowledge with the symposium and seminar findings confirmed that around 7 per cent of all charities genuinely think that they either should not, or will not, borrow and that social investment is fundamentally a bad idea. From our interviews this could be because of ethical concerns or simply because they feel that their charity's funding model should not be 'interfered with' by social investment in any form.

Equally, around 33 per cent of all organisations think that this is just a passing phase that will not impact their organisations. Many are happy in their grants and/or fundraising models and as such see no place for social investment at the moment.

Meanwhile, 46 per cent of organisations feel positive or very positive towards social investment, while 14 per cent feel this will be transformational.

Trustees are on the whole 20 per cent less positive about social investment compared to their management teams.

Finally, while large and major charities are most positive, small charities are also positive. It is only medium-sized charities that are not. Organisations predominately funded by fundraising are the least positive.

The main organisations that are positive about social investment and borrowing are those who understand it, and it is here we should put our effort into building demand for social investment through teaching, lecturing, mentoring and good case studies and support.

**We should build demand for
social investment through teaching,
mentoring, good case studies,
and support**

Appendix C:

Report methodology

This report is the product of five pieces of practitioner research undertaken during 2015/16 by the Centre for Charity Effectiveness at Cass Business School (Cass CCE).

C.1 Objectives

The key objectives of the research are:

- Assess the state of charity finance and identify the strategic forces impacting decisions
- Appraise the development of the market for social investment and evaluate critically to what extent this concurs with what charities demand
- Investigate the views and practices of charities in relation to financial strategy and social investment
- Formulate recommendations on how to overcome potential barriers.

C.2 Sources

This report brings together findings from:

1. A survey answered by 190 charities, funders and advisors, giving responses and trends around charity finance and social investment.
2. The symposium – with over 100 participants, it had keynote speeches on different topics across charity finance and social investment. Participants also provided video thoughts as ‘talking heads’ and brainstormed how social investment could help the sector in a ‘world café’ structured, conversational process.
3. A series of seminars on social investment entitled ‘Demystifying the hype’.
4. A literature review focused on the environment, barriers and mind-set of using social investment. Undertaken by James Knuckles and Kevin Curran, both PhD candidates at Cass Business School.
5. Face-to-face interviews with over 120 people from charities and investors with a wide range of opinions on social investment – both positive and negative.

We have also highlighted recent reports and academic articles to provide a broad picture to the reader.

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