# UK SOCIAL INVESTMENT – OPPORTUNITIES, CHALLENGES AND THE 'CRITICAL QUESTIONS'

November 2016

Social investment in the UK has a long history of serving charities, social enterprises and communities most in need. Big Society Capital (BSC) was established in 2012 to help accelerate the development of social investment in the UK. Whilst there has clearly been progress over recent years, there are many questions remaining about how social investment could and should most effectively target itself to make an impact in the future.

Therefore, at BSC, we are reviewing the landscape of social investment to understand what it looks like now and where it is headed. This forms the first part of a broader strategic review that BSC has now started and will continue in 2017.

This note outlines our current view of the social investment landscape, with a particular emphasis on the challenges and opportunities today. It focuses on a set of critical questions that may shape the future of social investment.

We offer this as an invitation to comment, agree with or challenge the information and views contained in it, and welcome all views. In particular, we would welcome engagement on the questions laid out in the final section ('Where we would like your help')

# BACKGROUND

*This note provides our view of the UK social investment landscape. We offer this as an invitation to comment, agree with or challenge the information and views contained in it, and welcome all views. This note deliberately includes some material that may be found challenging to some – not everything will be ultimately agreed with (or right!), but we thought it's time to put some real questions on the table to get some views about what's really happening in social investment.*

## Background

Social investment in the UK has a long history of serving charities, social enterprises and communities most in need. Big Society Capital (BSC) was established in 2012 to help accelerate the development of social investment in the UK.

Much has happened since the establishment of BSC. Social investment deals have increased in volume and number, the social investment landscape is more densely populated with more social investors, and there has been a great deal achieved by the charities and social enterprises that have received social investment. However, whilst there has clearly been progress, there are many questions remaining about how social investment could and should most effectively target itself to make an impact in the future.

Therefore, at BSC, we are now reviewing the landscape of social investment to try to understand the opportunities, the challenges and the 'critical questions' facing social investment in the future. We are keen to take a fresh look at social investment as a whole to understand new perspectives and where changes and redirections may be needed. This note forms part of this exercise. We are keen to take an open and collaborative approach in bringing these perspectives together.

This forms the first part of a broader strategic review that BSC has now started and will continue in 2017. This review, as described on our website here, is deliberately engaging with both BSC-related stakeholders and a broader group of stakeholders interested in social investment.

This will inform our thinking on our strategic direction and future activities. We aim to use this broader view of the social investment landscape to help us understand where to focus, through identifying where we can make the biggest difference and where we are most needed. We also hope it is useful as part of a broader conversation within social investment about how and where social investment and BSC can make the most impact.

## Purpose of this note

This note outlines our current view of the social investment landscape, with a particular emphasis on the challenges and opportunities today. It focuses on a set of critical questions that may shape the future of social investment. These have been developed from research inside BSC and a range of stakeholder discussions, and have been used within our strategy review process.

We hope this note is helpful to:
- Share our current perspective on the challenges and opportunities with interested stakeholders
- Get important feedback on the critical questions
- Advance the broader conversation on where social investment should go next

Throughout, this note refers to the accompanying background 'Evidence Pack' also released today (found here). This additional document contains background perspectives and analyses that inform the challenges, opportunities, and critical questions facing social investment today.

This note is deliberately brief to keep the focus on the critical questions. It has been developed through BSC's own efforts, and we have attempted to provide sufficient detail in the articulation of each question to understand their meaning. Not everything may be correct, and we welcome comments and corrections. Any faults remain BSC's own. We have also not attempted to provide all possible levels of detail and this note should not be read as a precise description of the state of the social investment market.

## About Big Society Capital

Big Society Capital is a financial institution with a social mission, set up to build the social investment market in the UK, so that charities and social enterprises can access appropriate repayable finance to enable them to grow, become more sustainable and increase their impact on society. It is doing this by building a diverse social investment market: encouraging investors to lend or invest money to achieve a social as well as a financial return. Since it was set up as an independent organisation in 2012, Big Society Capital has invested, along with its co-investors, over £270 million in specialist organisations who lend to charities and social enterprises. For more information visit www.bigsocietycapital.com

# CRITICAL QUESTIONS FOR SOCIAL INVESTMENT

## 1. Your Views

An exciting aspect of social investment is that many people see it as a vehicle to help progress their own objectives. This may be the way it can engage individual savers in a new type of investment, its potential influence on Government to focus more on outcomes, the opportunity to encourage collaboration between philanthropists and investors, or other objectives. Therefore, of course, there are a broad range of perspectives about what social investment is and how it should develop over the coming years.

The evidence pack touches on a number of the challenges and opportunities in social investment, but it is by no means exhaustive. We would therefore welcome your own views about social investment and its future.

**Critical Question 1:** What opportunity in social investment excites you the most? What challenge to social investment are you most concerned about?

## 2. Who needs social investment

Who needs social investment is vital to understand. By looking at who is currently using social investment, we can get a quick picture of who may need it in future.

We know that by 2015, the total stock of social investment outstanding in the UK was estimated to be £1.5Bn (see slide 5 in the Evidence Pack). To date, we believe this has gone primarily to asset-locked social sector organisations, which have been the recipients of around 70% of BSC's outstanding social investment by value (s. 16).

In the region of 6,000 such charities and social enterprises may have now received investment from social investors or mainstream banks (s. 6)

This figure represents a fraction of the total number of charities and social enterprises in this category: there are now estimated to be around 100,000 active in the UK. However, many of these organisations have relatively low revenues – with as many as 75% generating £100,000 per year or less (s. 18).

It seems reasonable to question how suitable repayable social investment may be for all charities and social enterprises of this size. As such, it is not a stretch to imagine that the universe of investible organisations may be in the low tens of thousands – perhaps between 15,000 and 26,000 organisations currently (s. 18).

But of course demand for social investment is not just who needs it, but also how much social investment is needed. Whilst we can learn something from the number of organisations above, the scale of capital need will vary significantly across sectors, product types, and organisational types. How much investment is needed will also be driven by ongoing innovation of products and business models.

However, getting a basic sense of the potential scale of the investible market is critical to taking social investment forward for two reasons. Firstly, it opens a question around the types of organisation to receive social investment. Secondly, it opens a question around the right type of finance suitable for the regulated social sector.

In the first instance, there may be a case for examining the other types of organisations that could deliver impact through the use of social investment (addressed in section 5, below).

In the second instance, it is worth considering that there may be a role for other forms of finance to charities and social enterprises. If there are elements of the social sector that should not take straight repayable finance, perhaps blended finance – mixing grant-funding with repayable finance (s. 24) – could play a greater role. Access, for example, is already exploring the ways in which such funding may be used.

**Critical Question 2:** Is there a limit to the amount of repayable investment needed in the regulated social sector, and if so, where do you think it is?

## 3. Who channels social investment

The number of intermediaries active in UK social investment has grown considerably in the last 5 years, to the point now that there are around 60 established intermediaries and 60 emerging players (s. 27), though we should note that not all of these entities are specialist social investment intermediaries.

This growth has followed the key priority of the UK Government and, independently, of Big Society Capital over the last 5 years – to grow the number of social investment intermediaries

However, progress towards the second priority – to ensure financial sustainability – is less clear. Sustainability remains challenging for dedicated social investment intermediaries, aside from those with significant assets under management or recurring forms of subsidy.

Sustainability may be particularly challenging for certain types of products. Persistent gaps remain in the supply of small and tailored social investment products, particularly affordable growth finance (s. 23). This product category, however, can be expensive to arrange and is often perceived to carry a higher risk profile, making it challenging for intermediaries to deliver cost-efficiently.

It is important that intermediaries be financially sustainable in order to effectively manage the flows of social investment capital. A strong core of fund management and investment arrangement intermediaries could improve the reach and effectiveness of social investment overall. Accessible advisory services could ensure that investors and charities and social enterprises receive the appropriate advice and have the appropriate capabilities to make and take on social investment. A suite of vibrant social infrastructure platforms could open up social investment to a broader range of investors.

Equally, social investment can only be effective if charities and social enterprises are receiving the types of finance they really need. Charities and social enterprises are looking for capital that is accessible and provided at an affordable rate. Similarly, capital should be provided over an appropriate term and in appropriate scale. Providing capital that more directly meets the needs of charities and social enterprises could catalyse significant growth in the impact generated by social investment in the UK.

Understanding how possible it may be to reconcile these issues is critical for social investment. It raises questions about what intermediation infrastructure is required, the nature of products provided, and the nature of support required for intermediaries. It is also worth noting that, as in other markets, we are increasingly seeing models of disintermediation emerging – for example crowdfunding and 'DIY social investment', which could be promising models to encourage broader distribution.

**Critical Question 3:** What kind of intermediation will be needed in the future, and how will we get there?

## 4. Who provides social investment

The range of investor groups in the UK has grown significantly in the last few years, and the landscape now includes a variety of new sources of capital (s. 30). These can perhaps be summarised in three broad groups:

- **Impact-led organisations:** This group may include trust & foundations, operational charities, international foundations, corporate foundations, and NHS foundations.
- **Channels to individuals:** This group may include crowdfunding organisations, donor advised funds, family offices, angel investors, wealth managers, financial advisors, and fund managers.
- **'Motivated' institutions:** This group may include faith-based groups, university endowments, venture fund managers, local authority pension funds, corporate pension funds, corporates, and mainstream financial institutions.

We have seen significant co-investment into scale social investment, notably investments into social housing and property-related funds from institutional investors and pension funds. Social investment in other areas (such as small charity loans, innovation finance and community finance) has been driven primarily by UK-based foundations and the Government (s. 29). It is interesting to note that individuals have contributed a large amount of investment already too (>£1bn), although this is mostly through deposits with social banks that is not all invested directly into charities and social enterprises.

Mobilising further substantial pools of impact-first capital has proved slower than some expected. There appears to be a mismatch between the risk and returns aspirations of the large pools of investor capital, and the types of investment needed by charities and social enterprises. Indeed, larger pools of capital, such as pension funds and segments of the retail/affluent investor space, may be less willing to take rates of return below market level in order to drive impact (s. 31).

Understanding the preferences of investors is therefore critical to the future of social investment, to understand the size and nature of the pool of capital available. Specifically, there may be a significant opportunity for social investment today to identify priority pools of capital (such as some individual investors) that are willing and able to engage in large-scale impact-first social investment opportunities.

**Critical Question 4:** What do most investors really want to invest in, and how many social investment opportunities would that include?

## 5. Who else makes an impact

As discussed in relation to Question 2 (Who needs social investment), there may be a case for examining the types of organisation, inside and alongside the regulated social sector, which could deliver impact through the use of social investment.

Much of social investment so far has focused on investments in the regulated social sector, a terminology used by the social investment tax relief in its launch in 2014 to include charities, community benefit societies and community interest companies. However, there are forms of asset-locked organisations that could be given more support and emphasis from social investment. Such organisations could include credit unions, community development finance institutions (CDFIs), a broad range of cooperatives, leisure and cultural trusts, supporters trusts, or agricultural initiatives (s. 19).

There are also organisations in addition to the traditional social sector that may make an impact through repayable finance, such as profit-with-purpose businesses or local businesses with local employment benefits. In addition, there may be a need for the generation of new business models and organisational types that do not exist yet to service evolving social needs. These may be supported by increasing cohorts of social entrepreneurs choosing legal forms for their organisations outside of the regulated social sector.

These organisations also face potential constraints however: they may not have sustainable revenue models, and in order to receive social investment from certain investors they would need to demonstrate measurable social impact. These organisations may also be able to receive investment from other mainstream sources of capital, therefore questioning whether social investment would be best spent on them.

Understanding the opportunities and challenges at this frontier is critical to social investment, as it could have significant implications for how investment could best be used.

**Critical Question 5:** Which vehicles, in addition to the regulated social sector, will make a significant impact in future – and are there any where there is a useful role for social investment?

## 6. Building the credibility of social investment

Some charities and social enterprises have very publicly used social investment to deliver large-scale change in the UK, notably HCT Group in the transport sector. However, there are few other such 'champions' that can claim to be as well known. Social investment is relatively well-known in the social sector and among some charitable foundations; however, it has relatively low presence in the public consciousness.

There are a number of ways to build greater awareness, understanding, and visible impact at scale – whether through communications campaigns, targeted educational efforts, select partnerships, or supporting further HCT-like groups in other sectors. For example, BSC has engaged in several major campaigns, such as 'Get SITR' and 'Get Informed', which have worked with social sector partners to drive broader engagement on targeted issues relevant to the sector.

However, the broader question is whether building credibility should be a priority for social investment. How much does this kind of credibility matter to the success of social investment?

On the one hand, building a deeper understanding of social investment among interested stakeholders may contribute to both the growth and the effectiveness of social investment. For example, if a greater number of institutional investors believe in social investment, they may be more willing to accept the required balance of risk and return. If social investment were better known to the general public, it may be able to unlock a significant pool of additional investment capital. If a greater number of charities and social enterprises are confident using social investment, they may be able to use it to increase their impact, focus on sustainability, and build partnerships with others.

On the other hand, focusing purely on building the credibility of a singular concept of 'social investment' may obscure the range of types of social investment, and the ultimate focus on using it as a tool to deliver impact. Building broader awareness of impactful activities may or may not contribute to this endeavour. In a resource-constrained environment, every choice of activity represents a trade-off – and activities to build awareness may not be critical to delivering an organisation's mission.

There is a further question, as to whether the case for social investment needs to be proven to stakeholders, and if so, which ones? Across the full spectrum of stakeholders, it may be important to engage with individual investors, institutional investors, charities and social enterprises, umbrella bodies, government, and others. Are certain stakeholders more sceptical? And is there a risk if they are not convinced of 'social investment' soon that they will withdraw support and the impact of social investment will suffer?

Understanding how important these activities are to the success of social investment is critical for the market going forward, as it will shape the path to a sustainable market for social investment. This also touches upon questions core to the purpose of social investment, in particular around whether broad public awareness should constitute a key pillar of success.

**Critical Question 6:** How much does increasing awareness, understanding and demonstrating visible impact at scale matter to making social investment a success? And to whom?

## 7. Who should social investment ultimately help

So far, Big Society Capital and others involved in social investment have often prioritised the ‘most disadvantaged’ population – seeking to address both the causes and consequences of poverty for the most disadvantaged ~10% of the population (s. 15).

This focus brings with it a number of benefits and a number of challenges. It focuses on delivering impact where it is most needed to a specific population in clear need. It brings finance to charities and social enterprises in real need of support, as they tackle some of the toughest social challenges. Additional finance can bring an increased level of resilience to these charities and social enterprises, as well as supporting greater service provision. For example, St Mungo’s charity has been able to expand its work with people at the risk of homelessness.

There are challenges, however, associated with this approach. Operating in such a tough environment, charities and social enterprises can struggle to remain financially sustainable. When working with the most disadvantaged, there are not always available and consistent revenue streams, which could be used to repay any finance.

In order to chart a path for social investment that can build the greatest impact possible over the long-term, it may be worth considering whether a broader proxy for beneficiary group would be helpful. For example, following the last Autumn Statement, commentary from think tanks (including IFS and Resolution Foundation) suggested that the poorest 30% of households will see incomes and living standards decrease in the next decade, many of these the ‘working poor.’ Would this be an appropriate target beneficiary group? A broader group could also emphasise support for developing healthy communities and building social capital particularly in deprived areas – through local businesses, sports centres, or arts funds – which is how several organisations globally are already considering and making these types of investments.

With this broader range of possible beneficiaries, there may be more readily available solutions to social problems and these may be more easily scaled and replicated given the scale of people effected. These solutions may also enable a greater focus on prevention across a range of social issues. These may also offer opportunity for more sustainable revenue models that could more consistently support repayable finance – and thereby attract greater interest from co-investors. Such an approach may increase the reach of social investment – which may increase the potential to driving systemic change over a period of time, and may provide opportunities to cross-subsidise investment in services that target the most disadvantaged.

Understanding who impact should be delivered for is critical to the future of social investment, as delivering improved outcomes is the ultimate measure of success.

**Critical Question 7:** Who should social impact ultimately be delivered for to make investment worthwhile?

## 8. Anything missing?

As discussed above, social investment encompasses many elements and many stakeholders. We have compiled a set of the most critical questions facing social investment today, but our view cannot ever be a complete one.

In order to best shape a more complete understanding of the opportunities and challenges facing social investment, we would appreciate your input on what we may be missing.

**Critical Question 8:** Are we missing important questions or perspectives? If so, what are they?

# SUMMARY OF CRITICAL QUESTIONS FOR SOCIAL INVESTMENT

**Critical Question 1:** What opportunity in social investment excites you the most? What challenge to social investment are you most concerned about?

**Critical Question 2:** Is there a limit to the amount of repayable investment needed in the regulated social sector, and if so, where do you think it is?

**Critical Question 3:** What kind of intermediary market will be needed in the future, and how will we get there?

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**Critical Question 8:** Are we missing important questions or perspectives? If so, what are they?



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# WHERE WE WOULD LIKE YOUR HELP

This note outlines what we currently see as a few of the critical questions facing social investment that are hopefully a start in analysing the challenges and opportunities facing social investment. As we seek to build on this perspective of social investment today, we are interested in hearing a broad range of opinions from interested stakeholders.

Specifically, if you are able and interested, we would like your views on:

- What are the answers to the questions?
- Are these the right questions?
- Which question(s) are the most important?

We are very grateful for all support and feedback provided to us, as we understand the effort involved in doing this.

### How to get in touch

We are seeking to solicit as broad a range of views as possible in a short period of time, and intend to use multiple mechanisms in order to do so.

- We would welcome **written responses** to the email address strategy@bigsocietycapital.com. For your own benefit, we would suggest responses of **no more than 4 pages** in writing. We would very much appreciate responses before **20th December 2016**.
- As part of our ongoing engagement process, we will be running a **webinar** on **8th December 2016** to provide any necessary clarification on the critical questions outlined here and the areas we are seeking to solicit your input. Register here.
- We will be reaching out to a number of stakeholders directly as well on specific issues of importance in order to solicit their feedback.

Many thanks again for reading and your assistance.