

FUNDING COMMISSION

Paper 1- Capitalisation and Social Investment- Emerging Findings and Recommendations

1. Introduction

The Funding Commission was set up by NCVO in February 2009 to respond to the sector's concerns and uncertainty about funding over the next 10 years and to set a new funding agenda.

The Commission is looking 10 years into the future and asking:

- What are the opportunities and challenges for civil society organisations in relation to their funding? In particular, what will be the implications of the new political and financial environment facing the sector?
- What new sources of funding could be developed? What new mechanisms are needed?
- What are the alternatives to conventional public sector funding?
- How can civil society organisations increase their own effectiveness and make better use of existing resources to achieve their missions?
- What changes to funding practice are required? How should the relationship between funder and funded be developed?
- What new skills, models, tools or other forms of support are needed to help the sector?

The Commission is chaired by Fiona Ellis, former Director of the Northern Rock Foundation, and includes a range of sector experts from funders, funding advisory bodies, fundraising, local voluntary action and social enterprise. The Secretary to the Commission is Richard Gutch and the Secretariat is provided by NCVO.

The Commission conducted an initial consultation exercise in 2009 and, since then, has met with a wide range of funding experts and commissioned papers on key issues of interest. It plans to report by the end of 2010, following consultation on its draft recommendations with key stakeholders.

The following 10 themes are being used to structure the Commission's work:

- Present and future context
- Capitalisation
- Social investment
- Individual giving
- Public sector funding
- Trading
- Trust and foundations
- Lottery
- Commercial sector support
- Effectiveness

The Commission expects to make up to 10 major recommendations, which it hopes will set the agenda for future work on the funding of the sector, whilst

also recognising all the work already going on in this field. The Commission's recommendations will often require time and resources to develop and take forward; in some cases the impact of the recommendations may not be felt for three to five years, whilst others may be more immediate. The Commission will be setting out a time line for the activities and outcomes expected for each recommendation, as well as making clear which part(s) of the sector the recommendation is particularly targeted at.

This is the first paper to be published by the Commission- on the Capitalisation and Social Investment themes.

FINDINGS

2. The need for capital

'£1 of unrestricted funding is worth £10 of project funding'¹

Although many civil society organisations (CSOs) are adept at squeezing out 15% contributions to core costs from their project grants, as part of full cost recovery, a continuing issue for most of them is a lack of access to capital, or unrestricted funds, that they can use to invest in their organisation to build capacity; develop new products and services; or cope with unexpected events. Some grant makers, like Capacitybuilders, a few trusts and foundations and even fewer public sector agencies will fund capacity building directly, but this is very much the exception. Most organisations find it difficult to raise capital; build reserves or generate a surplus from fees, contracts or grants.

For the sector as a whole, it is apparent that income and expenditure are very closely matched: in 2007/08 expenditure amounted to 93% of the sector's total income. Where this income is from the public sector, this situation can perpetuate dependency on government funding and makes organisations more vulnerable to changing policies and priorities. The close equivalence of income and expenditure is a reflection of the financial model underpinning most civil society activity.

As Clara Miller has argued², CSOs operate in a 'strange and often contradictory world' where the normal rules of doing business do not apply. In the private sector, businesses charge consumers a price that:

- covers the cost of developing as well as delivering a service or product;
- enables the company to invest in its future growth and productivity; and
- pays a dividend to owners or shareholders.

In contrast, CSOs usually have to secure funding from third parties (donors or government funders) on the basis of cost, rather than price. In practice, the emphasis on funding projects rather than organisations means that most find it difficult to raise sufficient revenue to cover the full cost of running a service, let alone generate a surplus. As Miller notes, 'the non-profit provider is left with the

¹ Quote from client of NCVO's Sustainable Funding Team

² C Miller, *The Looking-Glass World of Non-profit Money: managing in for-profits shadow*

difficult task of finding additional subsidy, turning proffered money away or providing under-capitalised services to clients, with eventual decline in quality’.

This can mean that organisations become preoccupied with sustaining existing activity, rather than focusing on their impact. As a 2007 study for the Office of the Third Sector found:

‘... the majority of [organisations] are in the position of focusing continually on organisational survival, sometimes necessitating some mission drift, and certainly in many cases at the expense of concentrating on the future development of the organisation.’³

By not being able to build the capacity of their organisation, CSOs are less able to innovate or withstand change. In the private sector, investment in infrastructure is part of the normal cost of doing business, necessary for long term efficiency and profitability. CSOs, on the other hand, can often find themselves being criticised for spending money on ‘administration’, or for having reserves in the bank, by donors and funders who want to see their money going directly to beneficiaries.

Obviously there is a balance to be struck between investing in organisational development and the direct costs of providing programmes and services. However, the sector is still a long way from finding the optimum point. This is partly because these two are seen by some as conflicting, rather than complementary functions and partly because there is too great a reliance on funding restricted for the direct work of the organisation. This is unsustainable in the long term. CSOs need access to unrestricted capital to maximise their impact and enable them to further their mission more efficiently and effectively.

Reserves

The need to strike the right balance between capital and revenue funding can be seen most clearly in relation to the amount of reserves an organisation holds. As the Charity Commission has stated: ‘Reserve levels that are set too high tie up money that could, or should be spent on charitable activity. If they are too low, the future of the charity may be put at risk’⁴.

The public (and some funders) are suspicious of charities that appear to ‘hoard’ reserves, rather than spend their money directly on beneficiaries. Yet if organisations themselves are not clear about why they need reserves or how much they need, they will be unable to allay fears that they are not using their money wisely. Every organisation needs to understand *why* it needs reserves, and what level of reserves is appropriate for their needs. This requires a certain level of financial literacy and an assessment of, for example, current and future needs, potential sources of funding and changes in the external environment.

³ SQW Ltd. *Research on Third Sector Access to Finance*. London: Office of the Third Sector, 2007.

⁴ Charity Commission, 2003, RS3 *Charity reserves*

This suggests a need for an informed debate amongst CSOs, donors, funders and the public about the cost of doing business and the need for reserves to build organisational resilience. Unless there is a willingness to invest in management and support services, information technology, or research and development, for example, CSOs will always have to struggle between short-term survival and long term impact. This in turn will undermine their capacity to deliver better services and programmes to beneficiaries.

However, some of the barriers that prevent organisations accessing the capital they need are internal. Too often reserves are held simply to cover contingencies, as evidenced by the ‘3-6 months running costs’ criterion, and are not seen a potential source of development capital. Organisations that have a good understanding of their current and future financial position and the sources of funding available to them are in a much better position to plan and prioritise their funding needs, thereby becoming more sustainable and resilient in the longer term. But many organisations do not have the financial literacy needed to differentiate between capital and revenue funding, or understand why both are needed. Poor financial and business planning and an aversion to risk can also translate into a reluctance to seek investment in the long term health and effectiveness of the organisation (see also the Commission’s forthcoming paper on the Effectiveness theme).

3. Access to capital

The availability of capital can make an organisation more resilient and give it the capacity to deliver its mission more effectively. CSOs use financial capital to build capacity in one of four ways:

- as *reserves* or *insurance* to give resilience, protecting the organisation and its activities against the unexpected happening;
- to acquire the *fixed assets* necessary to deliver on-going services, projects and activities;
- as *working capital* to manage timing differences between spending money and receiving it (cash flow) thereby enabling on-going activity;
- as *development capital* to fund the costs of:
 - growing existing services and projects
 - developing the infrastructure of the organisation e.g. through IT, or financial systems, or marketing
 - innovation in new products, processes and services;

Supply and demand

Different types of capital carry different levels of risk. Capital that is used to support the acquisition of fixed assets, such as premises, can be secured against those assets and is therefore relatively low-risk for both the investor and recipient. There is strong evidence of demand from CSOs for this type of

finance. For example, the majority (81%, £22m in 2008) of Charity Bank's loans are long-term (over five years to maturity) and are usually secured against fixed assets⁵. It is more difficult to assess the extent of demand for, and supply of working capital to the VCS, although it appears to be available through both commercial and social investment institutions. This includes the provision of overdraft facilities to help organisations cope with 'lumpy' cash flows, eg where payment is made in arrears.

Most CSOs will still look to sources of free capital for acquiring or developing fixed assets. This has been provided by a range of different grant makers, including the National Lottery, trusts and foundations and public sector agencies, as well as often being the basis of major appeals to the general public.

Less certain are the demand for and availability of development capital. The most significant source of development capital, as with capital for fixed assets, has been, and continues to be grants. More recently, however, there has been increasing publicity and promotion of loan finance as a source of capital for this type of investment. A number of studies have identified a need for development capital within the civil society sector⁶. However, the higher risk associated with loan finance, particularly in the context of contracting for public service delivery or for developing social enterprise, has meant that this level of need has not always been translated into demand.

The Government has actively intervened to increase the supply of development capital, through social investment funds such as the Adventure Capital Fund (£14m); Futurebuilders (£215m), Health Social Enterprises Investment Fund (SEIF) (£90m) and Communitybuilders (£70m), combining loan and grant finance. While there is evidence of good take up of some of this funding, again it is apparent that many organisations are reluctant to go down this route because of the cost of servicing the loan element and the perceived risk of such funding, if projected revenue streams fail to be realised. Some organisations have also, rightly, concluded they do not have the business planning skills or capacity to manage this type of finance. Take up of Futurebuilders and SEIF has also been limited to those organisations involved in public service delivery.

Over the next few years there is going to be an urgent need for CSOs to restructure and modernise to achieve economies of scale, increase efficiencies and modernise, both to survive the challenging financial environment, and to take advantage of new opportunities both in public service delivery and in fundraising and campaigning. For example, there could be more opportunities for both private and voluntary sector providers to deliver public services, provided they can deliver economies of scale and cost effectiveness. There is also likely to be much greater emphasis on payment by results, often requiring providers to put money upfront. Investment ahead of income

⁵ Charity Bank Ltd 2008 *Audited Financial Statements*

⁶ eg Bank of England 2003, *The Financing of Social Enterprises*; SQW Ltd. *Research on Third Sector Access to Finance*. London: Office of the Third Sector, 2007; National Audit Office 2009 *Building the capacity of the Third Sector* London: National Audit Office.

generation and evidence of profitability is high financial risk. Private companies have access to commercial capital markets and the expertise to manage this. CSOs that want to compete for contracts will need access to a more mature social investment market, as well as the right set of skills, in order to manage in this market. CSOs will also need to invest in developing their fundraising capacity as public sector funding shrinks.

4. The role of grant funders

Grant-funding plays a key role in meeting the development needs of CSOs. The Baring Foundation's *Strengthening the Voluntary Sector* programme, for example, aims to help organisations develop in order to further their mission more effectively and maintain their independence. However, the availability of capital investment in CSOs by grant funders has tended to be constrained by the same factors that inhibit the practice of all CSOs:

- a lack of understanding of the different approaches needed for capital investment and revenue funding;
- a reluctance to contribute to reserves or to fund organisations with reserves above a certain level;
- limited organisational capability to manage social investments; and
- a conservative approach to risk that might include, for example, a reluctance to invest in developments that do not have easily-identifiable outcomes.

Intelligent funding

A number of grant-making bodies have recognised that they need to change this financial model and fund more 'intelligently'. The intelligent funding model focuses on outcomes, rather than activities, and provides support to organisations to help them deliver and sustain the work throughout, and beyond the life of the grant. Although this may cost more to administer, it is more cost-effective in the long term if it means that grants are used more efficiently and effectively and thereby achieve greater impact. It is a model that could be used by other funders, including government.

Investment

Grant making foundations hold 31% of the sector's assets.⁷ This tends to be invested through commercial vehicles to attract a market-rate financial return. This approach to investment allows trusts and foundations to protect permanent endowments, and support CSOs through distribution of grants. However, it also means that most of this capital is not available for use within the sector. Investing more of the capital held by trusts and foundations in the sector would see greater supply (and therefore better access to capital), which could strengthen the financial resilience of CSOs and facilitate more voluntary activity.

⁷ If medical research organisations, which primarily achieve their mission by making grants to fund research, are included grant-making CSOs hold 50% of the sector's assets. 'The UK Civil Society Almanac 2009', NCVO, February 2009.

Some grant-making institutions have started to use their financial capital to support their mission⁸, either through:

- *Mission-Connected Investment*, investments made in line with charitable mission, but with expectation of near commercial returns; and
- *Programme-Related Investment*, investment that seeks a social as well as (or instead of) a financial return on capital.

Both these approaches, sometimes collectively described as *Impact Investing*, allow trusts and foundations to invest some of their endowments in ways that enable more of the money held by trusts and foundations for the sector to be actively used within the sector.

At the same time some trusts, such as the Esmee Fairbairn Foundation, have begun to use a broader range of financial instruments to increase the supply of capital to CSOs, for example by offering loans where other lenders are not prepared to take the risk, alongside their traditional grant-making activities. This means limited resources can be used as efficiently as possible, enabling capital to be recycled where possible, whilst ensuring that grants are still available for those who need them.

5. Developing a social investment market

A discernible, if immature, social investment market has developed in the UK over the last decade, with an ever-widening range of investors, funds, advisors and, importantly, CSOs participating. Some of the main players in this market are:

- Social investment banks, such as Charity Bank, Triodos and Unity Trust Bank
- Community Development Finance Institutions (CDFIs) and their trade body, the Community Development Finance Association (CDFA)
- Venture capital funds targeting disadvantaged areas, such as Bridges Community Ventures
- The range of government funds referred to in Section 3 above and the Social Investment Business, which manages them
- Niche providers of capital and support, such as CAF Venturesome and venture philanthropy funds, such as Impetus Trust
- Trusts and foundations, such as Esmee Fairbairn Foundation

This market has at least three functions:

- to build the capacity of the sector to achieve impact;
- to use financial capital efficiently within the sector; and
- to increase access to capital for the sector.

The infrastructure for the social investment market is also developing. This includes specialist funds to support particular activities (social enterprise), or sub-sectors (youth organisations), as well as a number of advice and information services to support organisations seeking capital and those wanting to invest in the sector.

⁸ eg N Sargon and M Bolton, 2008, *Mission Possible: Emerging opportunities for mission-connected investment*, London: New Economics Foundation; M Bolton, 2005, *Foundations and social investment*, London: Esmee Fairbairn Foundation.

However, the market for social investment is still poorly developed. A more mature market would give CSOs access to a wider range of funding and financial options than at present. A Social Investment Wholesale Bank (SIWB), funded by unclaimed assets, as proposed in the Dormant Bank and Building Society Accounts Act (2009), could help to facilitate the development of such a market. To be effective the SIWB will need to be fully independent of government and should have an explicit wholesale function: if it were to compete with existing retailers it would distort, rather than develop the market. It must also be sufficiently well capitalised and will need at least £250m of capital from the outset. This would enable it to operate independently and with minimal risk to its initial capital.

Individual investors

A question for the future is whether, and to what extent private individuals or institutions will be willing to invest money for a social as well as a financial return. A small but growing number of wealthy philanthropists have actively supported efforts to supply investment capital to CSOs⁹. Examples include the use of venture philanthropy through organisations such as the Impetus Trust and the Private Equity foundation, as well as social lending and social venture capital approaches through organisations such as Venturesome or Bridges Ventures Social Entrepreneurs Fund. These approaches and vehicles are designed to promote investment in organisations, not just projects, so that those organisations can reach more people and have a bigger impact than would otherwise be possible.

Relatively little progress has been made in getting more donors to support or invest in capital funding, particularly to smaller organisations, although there have been some notable exceptions like Scope's Venture Philanthropy package (see box below).

Scope's Grangewood Venture Philanthropy Package

Scope has £20m of property which is currently home to around 600 disabled adults. Most of these services are in desperate need of modernisation. Grangewood in Essex is one such service, which Scope plans to modernise by building 15 new flats where disabled people will be able to live independently.

The total cost of the project is £2.7m (£18,000 per unit), but Scope already owns the land, so needs to raise £1.8m to finance the project. The revenue for supporting each service user is funded by the local authority and Scope's business model means they can run the service at a surplus, which could support a £750,000 mortgage at a semi-commercial rate from lenders such as Charity Bank, Triodos and Unity Trust Bank. However, they will not lend until the remaining £1.05m is in place.

Scope's plan is to raise the deposit by selling 'packaged units to individual

⁹ Goodall and Kingston, 2009, *Access to Capital* London: Venturesome

investors, consisting of:

£1750	Net donation (needs to be £2800 gross)
£1750	Gift aid and tax relief
<u>£7000</u>	Three year interest free loan (repaid from sale of existing building)
<u>£10,500</u>	
<u>£7500</u>	Commercial loan to 'match fund' each investor unit
£18,000	Total for each unit

This means that every donor who gives £1750 net of gift aid and lends Scope £7000 interest free for three years generates £18,000 investment in the project i.e. leveraging by a factor of 10. Each unit holder will be issued with legal documentation and a 'Loan note'.

Scope has a number of actual and potential high net worth supporters who they are now approaching with this proposition. If successful, they plan to use this model to finance around £40m redevelopment of other services.

There have also been a small number of on-line initiatives, such as Kiva, which may also have wider potential. Kiva is a web-based intermediary that encourages and enables people to invest in projects to alleviate poverty through the provision of micro-finance. Unlike a charitable donation, the investment is in the form of a loan which is paid back. It was first established in the United States, where it raised \$100 million and attracted more than 500,000 lenders in its first four years. It has been operating in the UK since 2008.

This suggests that there is interest in micro-finance approaches, but it is at a relatively low level and applied to projects in developing countries, rather than in the UK. It remains to be seen whether the same principles can be applied in this country to fund civil society activity, particularly small scale projects.

Commercial investment

There is an important distinction to be made¹⁰ when discussing the aims of social investment (apart from grant funding), between:

- 'Impact' investment, which is defined as 'actively placing capital in businesses and funds that generate social and/or environmental good and a range of returns to the investor' e.g. from simply getting your money back to an above market return (= 'impact led capital').
- Commercial investment, where the prime aim is to achieve a financial return, but the investor may also be interested in achieving social impact. (= 'finance led capital').

Provision of finance led capital to the sector has increased significantly in recent years as the commercial banks and the social banks have both done more business with the sector, particularly around property purchases. However, provision of impact led capital is much harder to attract into the sector, but is

¹⁰ Parthenon Group/Bridges Ventures 'Investing for Impact-case studies across asset classes' 2010.

very important in meeting the need of many organisations to secure more development and working capital and to become more resilient.

Few organisations are able to repay unsecured loans at commercial prices. Nor should they be encouraged to take out loans on this basis. Banks themselves are interested in maximising financial returns first and may be uninterested in sacrificing even part of that in favour of social impact. Therefore commercial investment is only appropriate under certain conditions where the interests of investor and investee coincide, i.e. where there is opportunity to maximise social and financial returns. For example where:

- development costs can be secured against fixed assets (as in the case of a housing association or care home); and
- there are predictable income streams sufficient to cover the cost of servicing a loan.

However, there may be other ways in which financial institutions can support social investment. For example by acting as a broker for individuals who are willing to invest for social impact or by using their financial expertise to enable CSOs to achieve their goals.

Social Impact Bonds

There is currently growing interest in developing alternative models of social finance. These include taking commercial financial models and adapting them so that they align social and financial returns. For example, Social Impact Bonds, designed to fund longer-term interventions that address the root causes of social problems, rather than their consequences, eg to prevent reoffending by ex-prisoners.

These work by raising private investment on the strength of a government contract, where the government agrees to pay a proportion of any savings made as a result of the intervention (eg reducing the rate of offending and readmission to prison) to the investors. This has a number of advantages, including:

- giving CSOs a stable revenue stream that focuses on outcomes, rather than outputs, with financial risks borne by the investor;
- enabling government to continue to fund acute provision in parallel with preventive measures; and
- bringing private investment into the civil society sector.

The Social Impact Bond is currently being piloted by Social Finance with ex-offenders from Peterborough prison. Metrics for measuring performance have been agreed with the Ministry of Justice and initial investment has been secured from trusts and foundations and other agencies. If the pilot is a success, the bond has the potential to attract commercial investment. (see the Commission's forthcoming paper on the Public Sector Funding theme for further discussion of this approach).

Civil Society Organisations

Larger CSOs also have the potential to invest in developing the capacity of smaller CSOs operating in the same field. This would enable them to maximise

social impact for their beneficiaries, as well as potentially achieving economies of scale through collaborative working. A pilot to test out this approach is being run by New Philanthropy Capital in association with Joe Ludlow.

Health warning

The new approaches to capitalising the sector discussed in this paper will not be relevant to all types of CSOs and will continue to represent a small, but growing element of the funding of the sector. However, the need for capital is something which most types of CSOs share, apart from micro organisations operating on a completely voluntary basis. Grants will continue to be the main source of capital for most CSOs, but the challenge for the sector is to try and choose the most appropriate source of finance for particular needs- and to only use grants, when only grants will do.

EMERGING RECOMMENDATIONS

6. Aims

One way of measuring a better capitalised sector is through the levels of free reserves. In 2007/08 these stood at £16bn after discounting the amounts held by grant making, research, housing and religious bodies. The Commission's aspiration is to see this double by 2020. This could be achieved if CSOs maintained their 2007/08 surplus of income over expenditure (£1.7bn) for each of the next 10 years.

Increasing levels of free reserves is, in simple terms, achieved by either generating more, or spending less, income. Apart from fundraising, for many CSOs, this means either generating surpluses on, properly priced, contracts or projects; or raising new capital for investment in buildings and organisational development, rather than spending income for these purposes.

The first approach requires changes in behaviour by commissioners and grant makers, as well as by CSOs when negotiating contracts or applying for grants. The second approach requires a supply of different sources of investment capital, as well as an ability and willingness by CSOs to embrace new forms of finance.

The Commission's aims are both to make better use of existing funds to help capitalise the sector and to increase the amount of both 'impact led' capital and 'finance led' capital coming into the sector.

The Commission's aspiration is to help voluntary organisations double their level of free reserves by 2020 from £16bn to £32bn, thereby

¹¹ This aspiration excludes research, grant making, housing and religious organisations, whose levels of reserves are significantly higher than all other types of voluntary organisations. In order

increasing the sector's size, scope, capacity, independence and resilience.¹¹

7. Making better use of existing funding to capitalise the sector

This involves:

- increasing public understanding about the need for CSOs to develop their capacity through investing in:
 - governance
 - management, support services , IT systems and staff training
 - research and development.

- increasing the financial literacy of the sector and thereby helping it to:
 - recognise the need to acquire capital
 - understand that capital is not just fixed assets
 - be more willing to apply to funders for capital
 - analyse the full costs of service delivery, including the cost of capital and the need to generate surpluses
 - get better at risk management and become less risk averse
 - develop effective business plans which provide investors with the confidence to invest
 - make the best use of different types of funding e.g. only using grants where only grants will do, using debt, quasi equity or other financial instruments, where appropriate
 - recognise the importance of only using commercial capital where social objectives are aligned with commercial ones i.e. avoid mission drift in the pursuit of financial return.

- encouraging grant makers to:
 - fund full cost recovery plus a contribution to reserves where appropriate
 - provide grants for capacity building
 - provide longer term grants
 - complement debt finance provided by other investors with grants to fund those aspects of the investment where this is no financial return e.g. capacity building
 - recognise the importance of adequate levels of reserves, rather than seeing them as a reason not to give

- encouraging public sector commissioners to:
 - specify outcomes, rather than inputs and outputs
 - continue to use grants where appropriate
 - when procuring through competitive tendering, to pay by competitive price not by analysing costs

to achieve this aspiration, these other voluntary organisations would need to maintain their 2007/08 surplus of income over expenditure (£1.7bn) for each of the next 10 years.

- allow providers to retain surpluses
- invest in market development
- make full use of opportunities to transfer capital assets
- encouraging major charities to:
 - build the capacity of smaller charities working with the same client group, as a way of pursuing their mission more holistically
 - provide relevant business consultancy advice and investment
 - seek voluntary income, e.g. from venture philanthropy funders, to help pursue this approach.

Recommendations for helping make better use of existing funding

- A. The Charity Finance Directors Group to work with NCVO, NAVCA, ACEVO, Skills-Third Sector and other relevant bodies to secure funds and/or pro bono support from the commercial sector to build on and develop the financial literacy programmes currently available for sector chairs, treasurers, chief executives and directors of finance (or their equivalents in smaller organisations).**
- B. ACF and CFN to secure funds from some of their members to carry out a survey of current trust and foundations' grant making practice and use the results to help develop the grant making initiatives listed above.**

Target audience: all civil society organisations with resources (apart from micro organisations (< £10k) reliant on low levels of individual donations).

8. Increasing the new funds available for capitalising the sector

There are essentially three ways of attracting more capital into the sector:

- 1) Through attracting more grants or individual donations that can be used for capacity building. (see the Funding Commission's forthcoming papers on these themes).
- 2) Through attracting more impact led and more finance led capital, where the investor expects a financial return, even though it may only be just getting their money back.
- 3) Through a combination of 1) and 2) as in the Scope case study above.

Creating a market

A market requires the following conditions:

- Financial return for investors is achieved through CSOs:
 - Negotiating properly priced contracts with the public sector which reflect the cost of capital
 - direct trading with the public for goods or for services, such as long term care

- making surpluses through repayment of microloans for enterprises run by individual entrepreneurs in developing countries
- making efficiencies through collaboration, shared support services or merger with other organisations
- purchasing property instead of renting
- selling existing assets
- raising voluntary income (e.g. from a building appeal)
- Risks for investors are managed (but not necessarily eliminated) by:
 - Thorough due diligence of investment proposals
 - charges on property or on reserves
 - partnership funding with trusts and foundations, who can provide the grant element required to make the investment viable or to provide initial capacity
 - partnership funding with the public sector
 - government guarantees (where government has the explicit aim of leveraging private capital in order to supplement reduced government investment)
 - providing relevant advice on investment instruments being used
 - investors ultimately being willing to see a semi-commercial return.
- incentives for investors are provided through:
 - social recognition of individual philanthropists
 - tax incentives for providing capital (e.g. gift aid, inflation proofing and tax exemptions)
 - provision of financial return for investors as well as social return
 - provision of more capital to community development finance initiatives (CDFIs) through the SIWB to help them capitalise smaller CSOs
 - social impact bonds, providing investors with a share of savings to the public purse resulting from preventative services (see Funding Commission's forthcoming paper on Public Sector Funding for recommendations on Social Impact Bonds)
 - using the SIWB to encourage trusts and foundations to provide part of their endowments for investing in the sector by providing matched capital funding
 - using the SIWB to attract more private investment by only providing capital to lenders on a matched funding basis
 - requiring high street banks to invest in the sector through a Community Reinvestment Act, adapted to the circumstances of the UK (perhaps through specialist intermediaries, such as CDFIs)
 - Developing new forms of Gilts and Bonds, which provide opportunities to attract impact led and finance led capital.
- investors' reluctance is overcome through:

- development of a clearer menu of investment opportunities offering a range of different financial returns and social impacts
 - ensuring financial advisers are more aware of the potential for achieving financial and social return
 - equating social investment with ethical investment
 - emphasising that higher levels of social impact can be achieved this way than through a purely grants based approach
 - encouraging banks to develop new forms of financial instruments appropriate to the sector, pro bono, as part of their CSR activities.
- CSOs' reluctance is overcome through:
 - provision of business consultancy support to develop investment readiness (see Funding Commission's forthcoming paper on Effectiveness theme)
 - developing the advice available to trustees and CEOs to encourage them to be less risk averse (see Recommendation A)
 - inclusion of a grant element in investments where this is necessary for capacity building or for ensuring viability in adverse markets
 - development of new accounting protocols for distinguishing between earned and voluntary income and for the treatment of reserves and assets on balance sheets so that their purposes are more clearly and transparently identified.

Recommendations for increasing the capital coming into the sector

C. Treasury to establish a Task Force to assess the feasibility of, and recommend instruments for, attracting new private capital into investment (initially) in health and social care services provided by voluntary organisations or social enterprises. The Task Force should:

- **Comprise senior civil servants from the Treasury and relevant spending departments, investment bankers and representatives of the organisations in the health and social care sub sectors**
- **Consider the potential for :**
 - **a Social Gilt to attract investors concerned with social impact**
 - **Local Health and Social Care Bonds (e.g. for cities like Birmingham or Manchester) to attract investors who would benefit from, or are committed to, the improvement of local services**
 - **Replication of Scope's Venture Philanthropy Package**
- **Recommend appropriate mechanisms for investing the capital raised in voluntary organisations or social enterprises wanting to deliver more health or social care services, focussing in particular on long term health and social care, management of chronic health conditions and**

provision of personalised services, where demand is increasing and government is considering how best to respond

- Review the success of these investment instruments and advise on further investment mechanisms for other parts of the civil society sector.

Target audience: initially only those larger voluntary organisations and social enterprises in the health and social care sub sectors wanting to provide services and needing to develop capacity to respond to these developing markets. At a later date, if successful, the target audience could be broadened.

D. Government to help develop the market place for social investment through confirming the wholesale function of SIWB, supporting both impact led and finance led initiatives, and:

- allocating a higher portion of the unclaimed assets (£250m rather than £75m) to the SIWB, as recommended by the Social Investment Task Force
- exploring the potential for a proportion of the resale of national bank shares into the market to be earmarked for the SIWB
- requiring the SIWB to provide capital to lenders on a matched funding basis (i.e. lenders only receive SIWB capital if they raise matching capital from other sources of investment, such as government or trusts and foundations)
- requiring the SIWB to develop, or commission the development of, new financial mechanisms for licensing/franchising to CDFIs.

Target audience: service providing organisations, including social enterprises, which have a well-defined revenue stream.

Funding Commission
22 June 2010

QUESTIONS

- **Do you agree with the Findings?**
- **Are the four recommendations (A-D) the right way forward?**
- **What is missing?**
- **How can social investment benefit smaller, local CSOs?**
- **What is the potential for further transfer of community assets and for Community Shares programmes?**