SOCIAL INVESTMENT IN THE UK

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OVERVIEW

1. Social economy in the UK
2. Funding the social economy
3. A history of social investment
4. Social investment in the UK today
5. What next?
6. Lessons
SOCIAL ECONOMY IN THE UK

Social needs are met through a range of providers & institutions:

- **Government**: central and local authorities
- **For-profit sector**: private companies (e.g. public transportation)
- **Not-for-profit sector**:
  - Charities (~160,000)
  - Social enterprises (~70,000)
HOW IS THE SOCIAL ECONOMY FUNDED?

- Grants – from government agencies, independent grant-making trusts and foundations
- Donations
- Contracts for services
- Fees paid by service users
- Subsidised by other services

Social enterprise model
SHIFTING TO THE SOCIAL INVESTMENT PARADIGM

Economic crisis and politics of austerity has meant:

• **Less grants are available** → alternative social sector business models are required
• **Smaller government budgets** → public services are being opened up to private and third sector providers; third sector needs to remain competitive
• **New commissioning practices** (evidence based, payment by results; to outsource risk and demonstrate value) → existing social sector delivery models need refining/changing

- The social sector needs capital to change delivery & business models and to effectively take part in public service delivery
- However, social sector organisations rarely have their own financial reserves or access to private sector capital to manage this transition
EMERGENCE OF SOCIAL INVESTMENT

• Social investment = impact investment = social impact investment
• Capital for a social and financial return
• Repayable finance
• Measurement of social impact is key

• Social investment is used to:
  – Grow interventions that work
  – Transition to new business models
  – Carry on business as usual

UK Market has grown through the development of supply, demand and intermediation factors.
<table>
<thead>
<tr>
<th>Year</th>
<th>Demand</th>
<th>Supply</th>
<th>Intermediation</th>
<th>What is it?</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td></td>
<td>Social Investment Taskforce</td>
<td></td>
<td>Government (Treasury) backed, expert led investigation to develop the social investment market.</td>
</tr>
<tr>
<td>2001</td>
<td></td>
<td>UnLtd</td>
<td></td>
<td>Foundation for social entrepreneurs, providing early stage grant funding and capacity development support, building a pipeline for investment.</td>
</tr>
<tr>
<td>2002</td>
<td></td>
<td>Bridges Ventures</td>
<td></td>
<td>Community development venture fund, following a venture capital model. £20m was raised for the first fund with government providing match.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Charity Bank</td>
<td></td>
<td>A CDFI providing loans to charities and social enterprises.</td>
</tr>
<tr>
<td>2004</td>
<td></td>
<td>Futurebuilders</td>
<td></td>
<td>Government fund designed to strengthen social sector’s role in public service delivery. Provided grants, loans and investment readiness support.</td>
</tr>
<tr>
<td>2007</td>
<td></td>
<td>Social Finance</td>
<td></td>
<td>An intermediary developing new models of social change in the sector. Led the design of the first SIB.</td>
</tr>
<tr>
<td>2010</td>
<td></td>
<td>First Social Impact Bond</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2012</td>
<td></td>
<td>Investment and contract readiness fund</td>
<td></td>
<td>Government backed fund to drive investment readiness in the social sector.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Big Society Capital</td>
<td></td>
<td>Supplier of capital to social investment intermediaries and market development champion.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Social Value Act</td>
<td></td>
<td>Regulation that obliges government agencies to take into consideration social value when commissioning new services.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Ethex</td>
<td></td>
<td>An online platform for trading social investment products.</td>
</tr>
<tr>
<td>2013</td>
<td></td>
<td>Unit Cost Database</td>
<td></td>
<td>A database that aims to identify the unit cost of a given intervention, thereby allowing a value to be placed on savings resulting from a social intervention.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>What works centres</td>
<td></td>
<td>Specialist centres to support evidence based policy making and commissioning of effective interventions.</td>
</tr>
<tr>
<td>2014</td>
<td></td>
<td>Social Investment Tax Relief</td>
<td></td>
<td>Regulation designed to increase the flow of risk capital into the sector.</td>
</tr>
</tbody>
</table>
THE MARKET TODAY (1)

Overview

• Valued at approximately £202m (765 deals) in 2011/12, with the possibility of growing to £1bn by 2016/17.
• 30-40 intermediaries investing today.
• In 2011/12, 90% of the value investments made in that year were through secured loans.
THE MARKET TODAY (2)

Who provides social investment?

- Venture philanthropists
- Venture capital style funds
- Grant-makers
- Individuals
- Big Society Capital
THE MARKET TODAY (3)

Mechanisms

- Loans – secured and unsecured
- Equity
- Quasi-equity
- Social impact bonds
- Community share issues
- Crowdfunding
FEATURES OF THE UK MARKET

• Interplay of multiple actors
• Development of an ecosystem: demand, supply and intermediation
• Many angles (policy, market initiatives, support, product innovation)
• Is ambitious
• Has champions – Government, Big Society Capital
LESSONS FROM THE UK EXPERIENCE

- Government has played a crucial coordinating role
- Regulation has helped, but not the main driver
- Capacity building ecosystem
- Transparency & knowledge sharing key
QUESTIONS & DISCUSSION
APPENDIX 1:
THE UK SOCIAL INVESTMENT MARKET
THE INVESTEE SPECTRUM

Charity  Social enterprise  Social business  Traditional business

Impact first  Finance first

Blended financial AND social return
### DEFINING CHARACTERISTICS OF SOCIAL VENTURES

<table>
<thead>
<tr>
<th>Source of revenues</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Is an organisation reliant on voluntary income (charitable donations, grant and statutory income)? If so, it would normally be considered a charity</td>
</tr>
<tr>
<td>• Charities are able to generate up to 25% of their income through trading or earned income before needing to establish a separate trading arm</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Asset lock</th>
</tr>
</thead>
<tbody>
<tr>
<td>• The asset lock is a fundamental characteristic of a Community Interest Company, which ensures that the assets of the company are used solely for the benefit of the primary social purpose.</td>
</tr>
<tr>
<td>• For-profit businesses or not for profit companies limited by shares would only be deemed social if there was an asset lock embedded within their articles of association</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Dividend cap</th>
</tr>
</thead>
<tbody>
<tr>
<td>• For companies limited by shares, the dividend cap would be expected to be legally embedded, prioritising the distribution of at least 50% profits towards the primary social purpose, whether this is through reinvestment or otherwise (for example by gift aiding to a charitable organisation)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Primary purpose</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Is the organisation’s primary purpose to create social value and is this embedded in the articles of association or charitable objects? For companies limited by shares, social purpose must take precedent over creating shareholder value</td>
</tr>
</tbody>
</table>
## REGULATORY REFORMS

<table>
<thead>
<tr>
<th>New regulation</th>
<th>Outcome</th>
</tr>
</thead>
</table>
| **Community Investment Tax Relief (2002):**  
- A tax incentive for institutional and individual investors to invest in Community Development Finance Institutions (CDFIs) in the UK.  
- The taxpayer receives a relief of 5% of the amount invested per annum, in addition to any interest or dividend paid by the CDFI.  |  
- Take-up of the scheme has been limited (less than £100m)  
- Only a minority of CDFIs became accredited to use it.  
- Its design was too complex, the terms under which it can be used are too restrictive and public awareness has been limited. |
| **Community Interest Company (CIC) (2004):**  
- A company legal structure designed for social enterprises that want to use their profits and assets for public good.  
- These have three unique features:  
  - (1) they must have activities carried out for the benefit of their communities;  
  - (2) limited profit distribution;  
  - (3) they must publish an annual report of their activities to the CIC regulator.  |  
- In 2014, the number of CICs is now close to 10,000, and the number of applications increased 20% on 2013.  
- Although the CIC has legitimised and normalised the concept of a social enterprise, the dividend restrictions to external investors have been a significant disincentive to the supply of growth capital (such as equity). |
| **Social Value Act (2012):**  
- The Act requires public sector agencies, when commissioning a public service, to consider how the service they are procuring could bring added economic, environmental and social benefits.  
- In having to factor in social impact in public service procurement decisions, it is hoped that the number of social sector organisations needing financing will increase.  |  
- The Social Value Act came into force in early 2013.  
- There is limited data on the impact it has had on the sector, although there is some evidence that commissioners are beginning to embed consideration of social value in their practice. |
| **Social Investment Tax Relief (2014):**  
- Introduced to address the gap in the tax system for incentivising risk capital for small social sector organisations, this relief will give individuals investing in qualifying social organisations a reduction of 30% of that investment in their income tax bill for that year.  
- However, under EU state aid rules, the maximum investment amount is approximately £275k over 3 years, which is considered to be a limiting factor on the scheme.  |  
- It is too early to tell whether the Social Investment Tax Relief will have the intended effect of bringing new capital, particularly from high net worth individuals, into the sector.  
- The UK government is seeking consultation on enlarging scheme so that larger amounts are investable. |
# The Capacity Building Ecosystem

<table>
<thead>
<tr>
<th>Programme</th>
<th>Funder</th>
<th>Who is it aimed at?</th>
<th>What does it deliver?</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Social Incubator Fund</strong></td>
<td>Cabinet Office (Government)</td>
<td>Start-up and early stage social enterprises</td>
<td>The establishment of a number of social venture incubator programmes across the UK, ranging in geographical reach and thematic focus</td>
</tr>
<tr>
<td><strong>Big Potential</strong></td>
<td>Big Lottery Fund</td>
<td>Early stage social enterprises aiming to access impact investment and contracts of up to £500k</td>
<td>Capacity building grants that afford expert consultancy for frontline organisations</td>
</tr>
<tr>
<td><strong>Investment and Contract Readiness Fund</strong></td>
<td>Cabinet Office (Government)</td>
<td>Relatively mature social enterprise, aiming to access impact investment and contracts in excess of £500k</td>
<td>As above</td>
</tr>
<tr>
<td><strong>Big Venture Challenge</strong></td>
<td>Big Lottery Fund</td>
<td>Social enterprises with growth potential and delivery track record</td>
<td>An intensive investment readiness support programme, investment brokerage and match funding of investment</td>
</tr>
</tbody>
</table>
UK MARKET TRENDS AND ISSUES

• Launch of Big Society Capital catalysed interest, raised awareness and injected new capital into the sector – but was it the right kind?

• An acknowledged need for capital that can take a high risk, at lower amounts (less than £250k)

• Lots of interest in payment by results commissioning models – appealing from a commissioner perspective because you pay for interventions only for success and not up-front

• The rise of social impact bonds is linked with this

• Need for more thematic funds

• General acknowledgement for more evidence based practice – from social investors and grantmakers
APPENDIX 2: INVESTMENT MODELS
WHERE DO THE RETURNS COME FROM?

Outcomes based social investment
- Commissioner
- Realised savings
- Paid contract
- Fundraising
- Surplus
- Earned income

Traditional Social Investment
- Social venture
- Development capital / quasi equity
- Development capital / quasi equity

Legal obligation for the financial return

Source of cash to provide financial return

Social investment product
- Social impact bond
- Working capital
- Working capital / secured loan
- Surplus
- Earned income

The Young Foundation
Thinking Action Change
TYPES OF INVESTOR

HIGH INVOLVEMENT

FLOWER FIRST

- Impetus PEF
- Young Academy
- Bridges Ventures
- Nesta Impact Investments
- Angel investors
- Big Issue Invest
- CDFIs, local investment funds
- Sector banks: Charity Bank, CAF Bank, Triodos, Unity Trust
- High street banks

VENTURE PHILANTHROPY

- Increasing number of grant makers
- Esmee Fairbairn

IMPACT FIRST

- CAF Venturesome
- Nesta Impact Investments
- Bridges Ventures
- Angel investors
- Big Issue Invest
- CDFIs, local investment funds
- Sector banks: Charity Bank, CAF Bank, Triodos, Unity Trust
- High street banks

VENTURE CAPITAL

- Impetus PEF
- Young Academy
- Bridges Ventures
- Nesta Impact Investments
- Angel investors
- Big Issue Invest
- CDFIs, local investment funds
- Sector banks: Charity Bank, CAF Bank, Triodos, Unity Trust
- High street banks

FINANCE FIRST

- Impetus PEF
- Young Academy
- Bridges Ventures
- Nesta Impact Investments
- Angel investors
- Big Issue Invest
- CDFIs, local investment funds
- Sector banks: Charity Bank, CAF Bank, Triodos, Unity Trust
- High street banks

LOW INVOLVEMENT

Source: CAF
THE INVESTOR SPECTRUM

Grant makers
Venture Philanthropy
Impact Investors
Financial Investors

Wholesale Investors

Logos of various organizations related to social investment and philanthropy.
THE BIG SOCIETY CAPITAL MODEL

Source: Big Society Capital Annual Report 2013
APPENDIX 3: INVESTMENT EXAMPLES
**EXAMPLE 1: EQUITY**

**Overview:** The Gym provides low cost health and fitness facilities in purpose-built gyms which are open 24 hours a day.

**Investment rationale:** In 2007 there were very few low cost options for joining a gym. Municipal leisure centres offered low quality facilities whilst commercial gyms required high membership fees and inflexible contracts. Having seen the success of low cost gyms in the US and Germany, Bridges Ventures created The Gym model, based on offering state-of-the-art fitness facilities in purpose-built gyms which are open 24 hours and offer flexible memberships from as little as £10.99 per month.

**Exit:** Bridges Ventures sold its majority position in The Gym Group in June 2013. The transaction represented 50% IRR and 3.7x multiple for investors in Bridges funds, of which a minority was rolled over to retain a 25% stake in the company. In February 2014, the merger was announced between The Gym Group and Pure Gyms, which will improve the national footprint, create economies of scale and enable them to continue to compete and grow.

**Impact:** Over 50% of Gym locations are in underserved areas, 35% of members are first time gym goers and the company has contributed to employment and supply in areas of economic deprivation. At a strategic level, there is now a highly competitive market for low cost gyms meaning that going to the gym is now affordable for the masses not just the affluent. The deal was also awarded ‘Exit’ of the year in the 2013 Private Equity Awards – raising the profile of social investment.
EXAMPLE 2: QUASI-EQUITY

Overview: Enabling Enterprise aim for every young person to leave school equipped with the skills, experiences and aspirations to succeed. Their work supports this by offering enterprise skills, such as teamwork and financial literacy, via the medium of non-business subjects such as French and ICT. Enabling Enterprise offers complete packages of teacher training, structured weekly workshops and regular events in the school.

Investment rationale: When Tom joined the Learning Launchpad he was not yet full time on the business. The organisation had been going for 18 months during which time they’d worked with 870 young people and generated a small amount of income. They had a clear plan to expand the number of programmes and schools in which they were working, but this was reliant on them taking on paid employees. £25,000 investment was enough for them to take on staff and make the next step change in their growth.

Investment structure: The Young Foundation invested £25,000 through a revenue participation agreement which required Enabling Enterprise to make repayments based on a set % of their revenues each year for 10 years. As a CIC the level of interest payable was capped at 10% of the value of the amount invested. In addition to finance, The Young Foundation appointed one director to the board who helped provide ongoing strategic advice and support over the first few years as they implemented their growth plan.

Exit: The revenue participation agreement has a fixed term of 10 years, with repayments being made quarterly based on the level of income actually achieved by the organisation. The maximum level of repayment is capped such that payments will finish either when the maximum level has been reached, or the contract expires after 10 years, whichever is sooner.
EXAMPLE 3: DEBT

Overview: Motivation designs and distributes specialist wheelchairs to the developing world, allowing more people to become mobile. It also comes up with training programmes for wheelchair users in these countries focusing on skills for survival, empowerment and social inclusion.

Investment rationale: Even before the 2008/9 recession hit, Motivation’s management had the foresight to shift their business model to one that was more sustainable and less reliant on grants. However, it needed substantial up-front development capital to grow its commercial activities. The success of selling Motivation’s wheelchairs worldwide was not guaranteed, making the proposition particularly risky for Venturesome, whom it approached.

Investment structure: In 2009, Venturesome put in place a tailored investment structure that was part loan (£125k), part RPA (£75k), allowing it to take a share of revenues, up to a limit, as the enterprise grew. The RPA was repayable from the point of making the investment, whilst the loan element was repayable in 2011 in one tranche.

Exit: Motivation was consistent in making RPA payments. However, repayment of the £125k loan was split into two halves across 2011 and 2012 to support the venture’s cashflow.
EXAMPLE 4: SOCIAL IMPACT BOND (1)

- A way of financing Payment by Results (PbR) contracts delivered by social sector organisations (e.g. social enterprise).
- Up-front costs need to be covered in PbR contracts – social impact bonds (SIB) facilitate this.
- Social investor provides up-front capital and is repaid by commissioner on success of the social enterprise’s work. If no success, then no payment.

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Step 1: Commissioner

Step 2: Investor

Step 3: Social venture

Step 4: Beneficiaries

Cash  Service  Social value

Step 5:
EXAMPLE 4: SOCIAL IMPACT BOND (2)

Peterborough Social Impact Bond

Overview: In September 2010 HMP Peterborough became the site of the world’s first SIB. The SIB raised £5m external investment to fund a programme aimed at reducing re-offending rates among short-sentenced prisoners leaving Peterborough Prison.

Investment rationale: In the UK around 60% of adults who enter jail on short-term sentences will go on to re-offend within a year of release. It is estimated that the cost of imprisoning a single person in the UK is £40,000 plus an extra £40,000 for each year they spend incarcerated. Thus reducing recidivism amongst those most likely to re-enter the system stands to make considerable savings for the Ministry of Justice (MoJ).

In the Peterborough case, a number of charities were selected to deliver anti-recidivism interventions on a voluntary cohort of 3000 ex-offenders. The desire to invest money to achieve a social impact whilst still expecting a financial return, added to a growing interest in payment-by-results and social investment models were major reasons for investing in the project.

Investment structure: Outcome payments will be made if there is a 10% reduction in the number of reconviction events over 12 months compared to a control group, or if the SIB’s three cohorts achieve an average reduction of 7.5%. Payments are capped at £8m, which would see a rate of return of 13% for investors. The MoJ and Big Lottery Fund make the payments. The outcomes of the participants are measured against a ‘control group’. Payments relate to a reduction in the re-offending rate compared to the average of their control group over the following 12 months.

Source: http://data.gov.uk/sib_knowledge_box/ministry-justice-offenders-released-peterborough-prison
EXAMPLE 4: SOCIAL IMPACT BOND (3)

INVESTORS

£5 million Return depends on success

SOCIAL IMPACT PARTNERSHIP

Payment based on reduced convictions

MINISTRY OF JUSTICE/BIG LOTTERY FUND

St. Giles Trust
Support in prison, at the prison gates and in the community

Ormiston Trust
Support to prisoners' families while they are in prison and post release

SOVA
Providing volunteer support post intensive phase or with lower risk/need clients pre and post release

Other Interventions
Support needed by the prisoner, in prison and the community. Funded as the need is identified e.g. Lower level mental health support

3,000 male prisoners sentenced to less than 12 months

Reduction in re-offending

(from a presentation by David Hutchison, CEO of Social Finance, 2012)
# Active Social Impact Bonds

<table>
<thead>
<tr>
<th>Commissioner</th>
<th>Country</th>
<th>Outcome</th>
<th>Outcome Measure</th>
<th>Investor Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ministry of Justice</td>
<td>UK</td>
<td>Reduced reoffending</td>
<td>Number of conviction events in 12 months after release</td>
<td>£5m</td>
</tr>
<tr>
<td>Department for Work and Pensions (10 SIBs)</td>
<td>UK</td>
<td>Improved youth employment, education attainment, and/or job training</td>
<td>Several outcome measures</td>
<td>£10</td>
</tr>
<tr>
<td>Essex County Council</td>
<td>UK</td>
<td>Children in less need of care</td>
<td>Number of days in care</td>
<td>£3m</td>
</tr>
<tr>
<td>Greater London Authority</td>
<td>UK</td>
<td>Reduced homelessness</td>
<td>Reduced rough sleeping; moves to settled accommodation; reconnections abroad; increased employment; fewer A&amp;E hospital visits</td>
<td>£2m</td>
</tr>
<tr>
<td>Manchester City Council</td>
<td>UK</td>
<td>Reduction in the numbers of children in care</td>
<td>Number of weeks a young person stays out of care, and other wellbeing outcomes</td>
<td>TBD (contracts not yet signed)</td>
</tr>
<tr>
<td>IAAM</td>
<td>UK</td>
<td>Increase in adoption rate</td>
<td>Number of children achieving successful, lasting adoptions</td>
<td>£2m</td>
</tr>
<tr>
<td>The City of New York</td>
<td>USA</td>
<td>Reduced reoffending</td>
<td>Level of recidivism in the target cohort</td>
<td>$9.6m USD</td>
</tr>
<tr>
<td>State of Utah/United Way of Salt Lake</td>
<td>USA</td>
<td>Improved educational attainment</td>
<td>Use of special education/remedial services among the target cohort</td>
<td>$7m USD</td>
</tr>
<tr>
<td>New South Wales Department of Family and Children’s Services</td>
<td>Australia</td>
<td>Stronger families</td>
<td>Number of children in the cohort restored to their families from residential care</td>
<td>$7m AUD</td>
</tr>
</tbody>
</table>