Financing Social Enterprises in the UK

Prepared by

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Foreword

Social enterprises, or socially-driven businesses, often face greater difficulties accessing finance in comparison to purely commercial small and medium-sized enterprises. Often, their social mission overrides the fact that they are also resilient businesses; during the recent tough economic climate in 2009, 60% of social enterprises reported a profit, and a further 16% were breaking even.

Fortunately, there is an emerging pool of investors who are willing to take a long term view and are prepared to blend financial returns with social impact, as well as a growing number of intermediaries helping to connect investors with worthy ventures. However, this marketplace is fragmented and is currently structured to suit the preferences of investors rather than the social enterprises that it was developed to benefit.

The Social Investment Consultancy (TSIC) has written the attached brief, which I hope you find of interest, in order to share with you some of our insights on financing social enterprises. We believe that the formation of a social investment marketplace is an encouraging step, but the size and type of resources that are offered often do not reflect the needs of the majority of social enterprises.

Having incubated the social enterprise Future First (www.futurefirst.org.uk), as our own corporate responsibility programme, TSIC understands the struggle with accessing finance in this sector. In two years, Future First has progressed from grant funding through to soft loans and into commercial angel investment. However, we would not have been able to do this without our own financing to fill that 'missing middle' range, where funding is most scarce. Future First is now influencing policy and running programmes at a national level – at TSIC we are intent on supporting the social investment marketplace so that other enterprises may achieve the same.

On a positive note, our own research into high net worth individuals in 2010 uncovered a vast opportunity to better engage this group in the social sector. We want social enterprises to take full advantage of these opportunities in order to amplify their positive impact on our society. To achieve this, we need to offer support packages that cater to the needs of social enterprises in different stages of growth, and offer social visionaries both the capital and advice they need to succeed.

For any questions on our research and our services, please contact me on jake@tsiconsultancy.com or visit our website www.tsiconsultancy.com for more information

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Social enterprises need larger, more strategic investment packages.

The current size of the UK social investment market is only £190 million – tiny when compared to the £17 billion donated to charities annually.[1] However this market is estimated to exceed £300 billion globally in the next decade.[2]

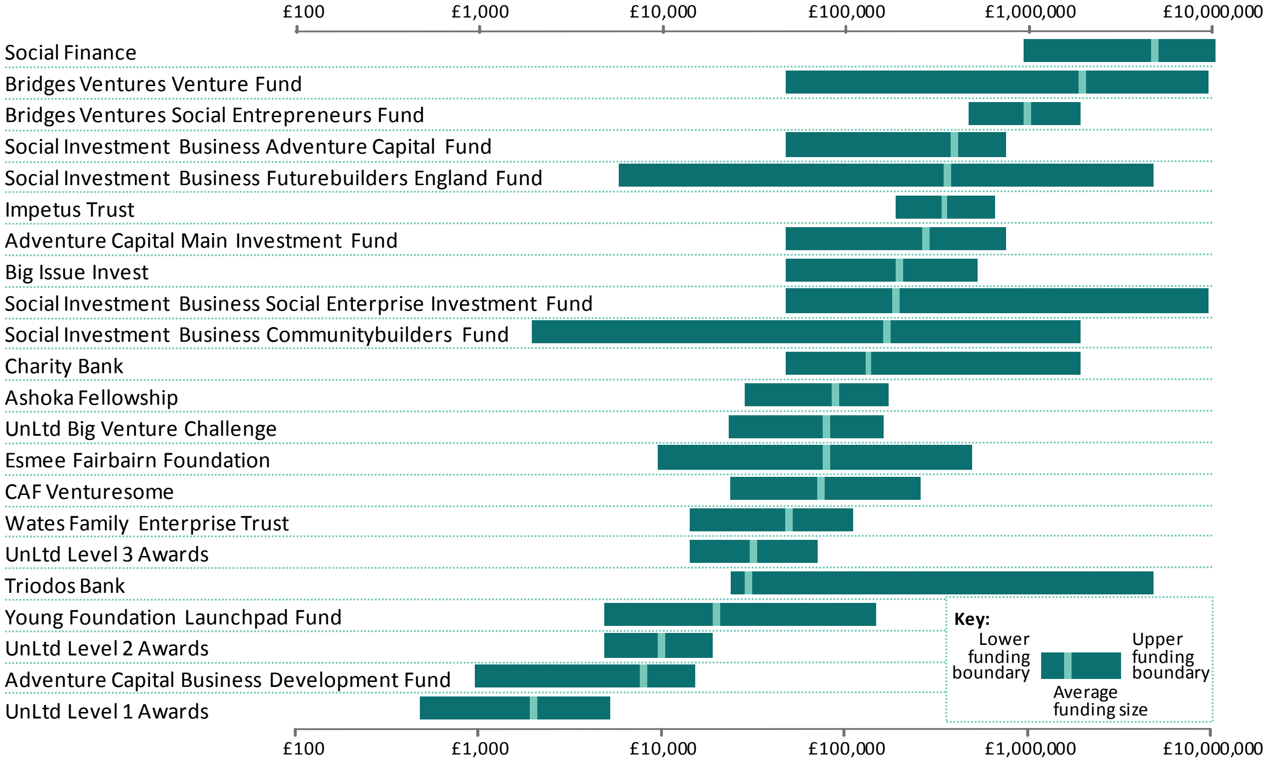
Despite these lofty projections, the current marketplace for social investment is highly decentralised and embryonic. In the UK alone there are thousands of organisations offering grants, loans and equity investments into social enterprises. The average investment amount is surprisingly small, with two-third of deals under £5,000[3]– meaning that social enterprises often resort to a patchwork of funding arrangements, each with its own reporting mechanism and expectation. This is hardly a conducive environment for social visionaries who should be more focused on their clients than funders.

The picture could be very different. The right size and type of investment would help social enterprises balance the funding cost and risk specific to their stage of growth: from seeding grants for start-ups, to equity financing for expansion, to structured debt products for large-scale working and investment capital.

The choice of grants, equity or loan is not that difficult if one can understand the underlying business model and then structure the most appropriate type of finance – however all too often social entrepreneurs have to accept whatever capital is offered rather than to think more strategically about what is best for their organisation.

In the diagram below, we have listed the investment size of 20 well-known funds[4] that provide preferential financing to social enterprises across the UK.

Size of Investments Made to UK Social Enterprises



Investors need to focus more on 'finance plus'.

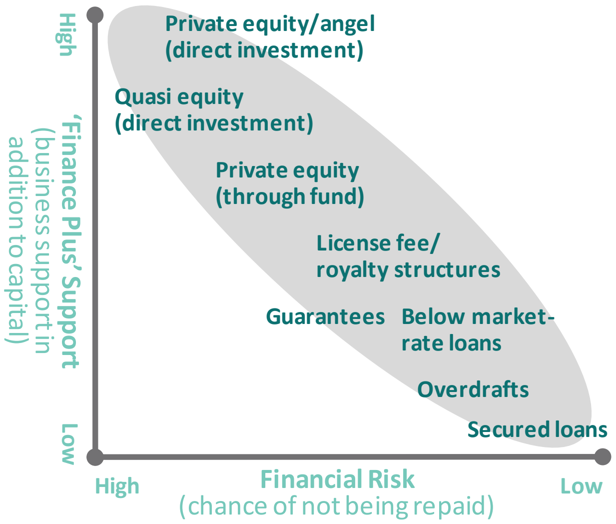
Innovation can often be found at a local level, among social enterprises that are funded by small-scale grants and led by committed individuals who are often sacrificing a market-rate salary in order to pursue their social beliefs. However many successful social enterprises lack the resources to reach the next stage - both in terms of capital as well as the capacity to scale up their organisation.

Similar to the bottom-of-pyramid market, the 'missing middle' also exists within the UK social enterprise industry. Across the vast array of social investors, there are only a handful of funding organisations focused on investments between the £50,000 and £200,000 mark. Individual investors often do not have the risk appetite to write cheques at this level, while institutional investors often see this range as being too costly given the necessary due diligence and transaction cost at an average of £5,000.[5]

In addition to capital, social enterprises in pivotal stages of growth often require 'finance-plus' support – tapping into the expertise and professional network of investors experienced in a relevant field. For investors who are serial entrepreneurs, this may offer an exciting opportunity to support innovation and help jump-start a social venture. Obviously, this would not suit all investors and it doesn't need to. Investors who prefer a more 'hands-off' approach can opt for more debt-like instruments or channel their investment through an intermediary.

For investors who are able to, and wish to offer their own expertise, the intangible value can be tremendous. Southwark Offenders Support (SOS) runs a mentoring programme for UK prisoners, and has helped to reduce the reoffending rate by seven- fold. The founder, Junior Smart, was fortunate enough to have an investor who not only helped fund his innovative organisation, but also took an active role in guiding him to expand and grow. This particular investor helped Smart pitch to a larger pool of executives as well as gain access to senior public figures to advocate for more effective prison policies; networks he would have otherwise have found difficult to access. Investors of this nature helped Smart to accelerate the expansion of SOS from one to four prisons across the UK.

Types of Financing and Opportunity for Investor's Engagement



The diagram above highlights common types of financing arrangement for social enterprises, as well as their relative opportunities for investors to engage directly with the social mission. Although some funders may package technical support alongside loans and grants, equity-type financing provides the most intrinsic opportunities for finance-plus support as the investor's return is linked directly to the success of the enterprise. Angel investors are especially known for offering not only their capital, but to also share their expertise, network and perhaps most importantly, passion for the cause.

Conclusion

Pumping more capital into the sector is unlikely by itself to generate growth, without careful planning on how the investment could be best used. Effective support for social entrepreneurs requires the right size and package of investment that reflects the enterprise's stage of growth.

Attracting investors who are willing to invest capital, expertise and access to professional networks will be central to building a more effective social sector. With more than 200,000 social enterprises in the UK,[6] it's not only a matter of seeding innovation, but to help grow them into a sustainable scale.[7]

References:

1 Cabinet Office, 2011. Growing the Social Investment Market: A vision and strategy.

2 J.P. Morgan Global Research, 2010. Impact Investments. An emerging asset class.

3 The Young Foundation, 2011. Growing Social Ventures.

4 TSIC research. Data obtained through website, annual report and press releases of individual funds.

5 Cabinet Office, 2011. Growing the Social Investment Market: A vision and strategy.

6 Ashoka UK, 2011. Event 'Ashoka Fellows in the UK', March 2011.

7 Delta Economics, 2010. Hidden Social Enterprises Report.

About TSIC

The Social Investment Consultancy (TSIC) is a strategy consulting firm operating at the intersection of the for- and non-profit worlds.

Our consultants have in-depth experience of working in-house for and consulting to many of the world's leading private and charitable organisations. The integration of skills and expertise from across the public, private and third sector forms the basis for a range of professional services that drive social impact and organisational change.

We provide businesses, foundations, philanthropists, charities and social enterprises with the advice and support they need to reach scale and maximise their social impact.

For more information on our research and services, or to connect with our teams in London, Dubai or New York, please visit www.tsiconsultancy.com or follow us on Twitter @tsiclondon.

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