IRIDESCENT IDEAS™

Business advice with a different perspective

What is social Investment?

Social investment is the use of repayable finance to achieve a social as well as a financial return

Types of social investment

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Secured loan: *Use your tangible assets to raise funds*

The borrower will pledge a tangible asset (known as "collateral") such as a building or equipment to receive a loan. In the event of a default, the lender can take possession of the asset which can then be sold to recoup the loan. A long-term, secured loan on property is known as a "mortgage".

Who might use it?

An organisation that owns an asset will be able to secure a loan against this asset for a variety of purposes such as growth, working capital or for projects. This security reduces the risk for the lender; and reduces the loan interest rate. The lender will have a fall-back option of selling the asset in the event of a default. The security is typically in the form of property or equipment, but can also be cash deposits. The borrower must demonstrate that it will be able to repay the loan from its income streams as the lender would rather have this than take the more expensive route of selling the collateral. Loans with terms of more than 5 years usually need to be secured as there is less certainty about future income to repay the loan.

Overdraft facility: *Secure agreed credit when your account reaches zero*

This is credit from a lender when a borrower's account reaches zero. An overdraft occurs when money is withdrawn from a bank account and the available balance goes below zero. In this situation, the account is said to be "overdrawn". If there is a prior agreement with the bank and the amount overdrawn is within the authorised limit, the interest is normally charged at an agreed rate. If the negative balance exceeds the agreed terms, then additional fees may be charged and higher interest rates may apply.

Who might use it?

Overdrafts allow the organisation to withdraw funds from an account even if there is no money left in it. Therefore, it is borrowing money at a pre-set interest rate and the overdraft limit itself will be set beforehand. An overdraft is offered by most banks, but is can be difficult for charities and social enterprises to obtain. However, there are now more organisations willing to provide overdrafts to the sector.

Standby/underwriting facility: *Secure credit to use if / when income drops*

This is a commitment by a lender to advance a specified amount of funds for a period of time (i.e. a line of credit) for a particular project, which may be drawn down only if budgeted income does not materialise. Interest is only paid on the amount drawn down. This facility will provide financing if other sources fail.

Who might use it?

An organisation may need an overdraft facility but be unable to obtain one due to its perceived credit worthiness. A standby facility is similar to an overdraft as the lender will make available a previously agreed sum of funds for a particular time period, which the organisation can use if needed. Unlike an overdraft, the facility is only available for a certain time period and does not "revolve" (i.e. repaid amounts reduce the overall size of the credit, so when the full amount has been drawn down credit will not be replenished). A standby facility need not be drawn down, but allows an organisation to have a "safety net" in managing its cashflow fluctuations.

Bridging loan: *Finance to cover short-term cashflow shortfalls*

Many grants are paid in arrears (and some are also paid late) and some contracts will also be paid at the end of the term. This can lead to short-term cashflow shortfalls. A bridging loan enables an organisation to manage these mismatches in the timings of income and expenditure (i.e. temporary shortfalls). The loan is repaid when the delayed payment is finally received.

Who might use it?

A bridging loan can underpin a short-term cashflow shortfall before a committed grant or other secured income is actually received by an organisation. It is a low risk facility as there is a guaranteed repayment of the lender's funds once the income in arrears is paid. Therefore, the interest rate on this type of facility will typically be low. As long as an organisation can show that there will be a grant or other income being paid at a specific point, a bridging facility can help solve tricky timing issues where there is a mismatch between the timing of income and expenditure.

Pre-funding of fundraising: *Loans which help meet short-term fundraising targets*

Charities and social enterprises often fundraise for building or refurbishment projects. The problem with such fundraising is that it is often hard to raise the full amount before the cost of the project goes up. So typically, the last 20% is hard to complete. This type of facility enables the project to commence and the loan is repaid through future fundraised income. This is also known as "last brick" financing.

Who might use it?

An organisation which relies on fundraising will be able to utilise this facility as income can be 'lumpy' whilst expenditure has a more consistent pattern. The pre-funding facility does not have to be drawn down and interest will be paid only on the funds used. This facility is similar to a bridging loan; it "bridges" to future fundraised income instead of grants and contract payments. An example of this is when an organisation is fundraising for a new building, and requires a bridging loan to enable it to proceed as it wishes to take advantage of a fixed contract price for building work.

Working capital facility: *Finance to support dips in cash flow*

Many organisations can have cashflow problems due to the timing differences between outgoing and incoming payments and the lack of cash reserves. Working capital is used to finance the everyday operations of an organisation.

Who might use it?

An organisation may have a working capital shortage owing to the time lapse between bills being paid and invoices being settled. Working capital will fill these 'gaps', enabling an organisation to function normally until operating expenses can be consistently covered by revenue. This facility can be in the form of an unsecured loan, overdraft, standby facility, an equity or quasi-equity investment. An organisation can have assets or run profitable activities, but be short of liquidity if its assets cannot readily be converted into cash. Working capital is required to ensure that an organisation is able to continue its operations and that it has sufficient funds to meet its operational expenses. The management of working capital involves managing inventories, accounts receivable and payable, and cash. The funds can be used for everyday use, for example to pay rent, utilities, salaries, inventory and marketing, to counter any 'lumpy' income streams.

Grant: *Finance which expects no financial return*

A grant is a conditional or unconditional gift of money with no expectation of a financial return (i.e. an expected financial return of "– 100 %"). It is also known as a "donation" or "gift capital".

Who might use it?

Grant-making trusts, individual philanthropists, companies or the government may make a grant to an organisation with a charitable purpose for "restricted" or "unrestricted" use. If the funds are for a specific project or narrower purpose than the organisation's objectives, they are "restricted". As this restriction is an obligation under trust law, the funds cannot be used for any other purpose (even if the project increases expenses in other areas such as HR and IT). With these conditions in place, the organisation operates a 'cash-in, cash-out' model for those specific projects. If the funds are not used for the specific project or group of beneficiaries, it should be returned to the donor as it was given for a specific purpose. Funds can also be "unrestricted" and therefore used exactly where the organisation needs the money to further its objectives. The management team and trustees can decide where this

money should be spent, e.g. for a specific project, working capital, growth or to build reserves for long term plans.

Philanthropic capital: *Used by foundations and philanthropists to create social benefits*

Philanthropic capital is a broad term which describes capital that has no expectation of any financial return. It can, therefore, be used strategically in ways that can enable financial structures to be created (e.g. firstloss tranches) or to leverage in other funds (e.g. using financial guarantees).

Who might use it?

Foundations and philanthropists who provide finance to increase the overall level of investment and innovation in civil society. Philanthropic capital aims to achieve systematic change in the social investment market. Such capital, for example, can act as a financial guarantee to leverage in more funds from both within and outside the social sector as it can reduce the risk (perceived or actual) or act as a "signal" to encourage other investors. For example, if it is part of a social investment fund, it may entice investment from other investors (including commercial funds) due to the signalling and risk mitigation effect, leading to more finance for the overall market. This type of investment may also encourage innovation in the sector, bringing about charitable bonds, social impact bonds and high risk (but high yield) finance for high-impact organisations. Without this philanthropic capital, many social investment funds would be unable to make some investments to innovative organisations because, even for them, the investment would be too risky. Innovation is high risk, and philanthropic capital enables new social investment products to be created.

Community investment: *Selling shares to people in the community to create a co-operative enterprise*

Community investment works by selling a share in an enterprise to people in the community. These people, as shareholders, control the enterprise. Members of a Co-operative Society or Community Benefit Society can become community shareholders and invest in local enterprises providing goods and services that meet local needs. Members only expect a fair and modest return on their investment. The return payable is based on the principle that interest should be no more than is sufficient to attract and retain the investment. Members invest on the understanding they will be rewarded primarily through a social dividend rather than a monetary dividend. Co-operative Societies or Community Benefit Societies are particularly appropriate for organisations wishing to raise capital from their members as they have several special attributes that make them different to companies in this regard, one of which is enshrined democracy and protection of members' rights: Cooperative Societies or Community Benefit Societies have to operate on a 'one member, one vote' basis, regardless of the number of shares owned.

Who might use it?

People or communities who want to raise finance for a community project or resource that will generate its own income, like a building, a shop, renewable energy project or other community enterprise. Community investment will only work if there is, at least potentially, a community that is willing and able to support the enterprise.

Without a community that has a shared identity and a common purpose, the idea will not work. But with a fully engaged community providing the capital for a community enterprise, there is real scope to improve the quality of community life. Ownership and investment go together to form a strong bond, engaging communities in enterprises that serve their interests. Investors are more likely to become loyal customers, volunteers and activists that support the enterprise in achieving its purpose. Community investment can strengthen the business model, but it also carries the risk that people's money will be lost or their expectations will not be met. This type of share capital cannot be transferred between people. Instead, the society allows shareholders to withdraw their share capital, subject to terms and conditions that protect the society's financial security. This means that a shareholder can cash in their shares with relative ease. Shareholders have a share account, and can increase or decrease their shareholding, or close the account altogether by withdrawing all their share capital.

Venture philanthropy: *High-engagement grant-making*

This is high-engagement grant-making, which can be summarised as "grants plus advice". Venture philanthropy takes concepts and techniques from venture capital finance and high technology business management to apply them to achieving philanthropic goals through innovative grant-making.

Who might use it?

This is a form of strategic philanthropy in which the grant-maker not only provides money but also advice, access to specialist expertise and sometimes board members. It is most appropriate for organisations needing growth capital with ambitions for scaling-up. Venture philanthropy provides "unrestricted" grants but this is integrated with tailored expertise and management support to assist the organisation to grow and improve its social impact. In the US, this approach predominantly uses grant finance. However in Europe, loan and quasi-equity finance may be used alongside grants. Recipient organisations do not have to be registered charities but must have a positive social or environmental impact.

Patient capital: *Suitable for big social or environmental impact project*

Patient capital is a loan with soft terms (typically low or no interest rates) and over a longer periods (usually more than 5 years).

Who might use it?

Organisations that might be deemed too risky for conventional investors, and even some social investors, might be able to use this type of financing. Patient capital is utilised in the social sector as some investors might be willing to forgo financial returns for social and environmental impact in the long run. The longterm time horizon allows funds to be used effectively for growth and high-risk, high-impact initiatives. Most providers of patient capital are also willing to support management with advice as they grow the organisation, so that the probability of high social impact is increased.

Growth/development capital: *Finance to help an organisation or project grow*

This is capital that will be invested in a start-up or for the significant growth of a civil society organisation for the development of its products, services or projects which may generate surplus income.

Who might use it?

Organisations that have plans to grow will be able to use this capital as the majority of charities and social enterprises use their income and expenditure directly on day-to-day activities, leaving little surplus in reserves. This leads to an inability to invest in innovation and development, which are important for the long-term robustness and growth of the organisation. Growth and development may be achieved through investment in "assets" as these have the potential to generate additional income. It may also take the form of an upfront investment to seize a market opportunity. Financial instruments such as equity, quasi-equity and patient capital can support and supplement grant funding for such capacity building. 'Hard' development capital refers to investment in property or other tangible assets. 'Soft' development capital describes investment in products or services, e.g. additional staff for fundraising support.

Equity investment: *Finance from the sale of your shares*

This means investment through the purchase of share capital. If a civil society organisation's legal structure allows it (i.e. a company limited by shares), it can sell its shares to individuals or institutions. The funds can then be used for start-up, growth or working capital.

Who might use it?

A company limited by shares is able to sell some or all of its shares to investors. However, this may dilute ownership and control of the company as shareholders may be able to make their demands on the management team to change operational strategy. Investors will also expect dividends, so not all funds will be re-invested in to the company. Most civil society organisations are constituted as companies limited by guarantee. (i.e. with no share capital) and so equity investments are generally rare. Additionally, exit strategies are not always forthcoming as equity offerings in the social sector are typically illiquid (there are few opportunities to buy and sell equity in civil society organisations). There is no established market for the shares, so it may take a long time before another investor can be found to exchange shares.

Quasi-equity/revenue participation: *Combining some of the benefits of equity and debt*

Quasi-equity fills the gap between debt and equity and aims to reflect some of the characteristics of both. Quasi-equity, also known as revenue participation investment, is usually structured as investments where the financial return is calculated as a percentage of the investee's future revenue streams.

Who might use it?

A quasi-equity investment can be a useful source of finance when debt financing is inappropriate or too onerous for charities or social enterprises, or where share

capital may not be possible due to the investee's legal structure. Unlike a loan, this investment is dependent on the financial performance of the organisation. If future expected financial performance is not achieved, a lower or possibly zero financial return is paid to the investor. Conversely, if performance is better than expected, then a higher financial return may be payable. A quasi-equity investment may be structured so that its return is capped (e.g. revenue participation payments cannot exceed double to the original investment size), or be limited in duration (e.g. the right to revenue participation is extinguished after a specified period of time). Quasiequity can be utilised by any organisation, but may be more attractive to a social enterprise that cannot offer shares or if a loan would be too risky. Quasi-equity provides a more equal sharing of risk and reward between investor and investee.

Community Development Finance Institutions (CDFIs): *Finance from small social investment providers*

CDFIs are small independent organisations that will typically only lend to underserved markets and to those who have been unable to obtain finance from mainstream sources.

Who might use it?

Small and medium-sized enterprises, social enterprises and individuals can apply to a CDFI for a loan if they cannot obtain a loan from mainstream financial sources. CDFIs operate in deprived areas where there are numerous organisations or individuals who cannot secure credit from traditional financial institutions. Some providers may require proof that the customer was unable to acquire finance from traditional lenders, so that their funds offer new, increased finance, rather than replacing traditional sources. Some CDFIs offer loan finance, others provide equity investment and a few offer both. Some also provide debt advice. This finance can be used for a variety of purposes such as for working capital, bridging capital, startup capital, tangible asset purchase and personal loans. Even though these loans are cheaper than those from high risk funds, it would be more expensive than credit unions and traditional credit providers.

Social impact bonds: *Investment from the private sector*

Social Impact Bonds (SIB) are a form of outcomes-based contracts between the public and private sector. The former agrees to pay for substantial improvement in social outcomes for a specific population, which will reduce the public sector's costs in the long run. The private sector initially pays for intervention, which is delivered by service providers with a proven track record. The private sector will only be repaid if a significant social impact is achieved.

Who might use it?

If a charity or social enterprise is able to demonstrate its high social impact, it may be able to collaborate with a financial intermediary to attract external finance through an SIB. The civil society organisation provides the service to the target population, which aims to reduce future public sector costs. Private funds will finance the intervention, delivered by an organisation with a good track record. The public sector pays for improved social outcomes that result in public savings as

these bonds are based on the theory that early intervention can help prevent subsequent serious problems.

Unlike traditional bonds, SIBs do not have a fixed rate of return; financial return depends on the achievement of specific social outcomes set at the start of the bond issue. The higher the social impact, the higher the return earned by the private sector. It is, therefore, important to choose effective and proven civil society organisations. The civil society organisation bears no financial risk as the repayment is between the public and private sector; the only risk borne is reputational. SIBs provide upfront funding for prevention and early intervention services. The public sector pays if (and only if) the intervention is successful. Therefore, SIBs re-allocate the risk between the public and private sector.

Charitable bonds: *Using long-term debt to finance growth*

Charities and social enterprises can issue bonds as a form of long-term debt to expand business operations.

Who might use it?

An organisation may be able to issue bonds if it has a viable underlying source of revenue with which to repay the bond holders (e.g. an organisation which operates a chain of charity shops). As this form of finance is still emerging in the social sector, there are various types of bonds in existence:

The bonds issued by Allia combine an investment to an AA-rated social housing provider, which repays the loan with interest and additionally provides a grant to a charity.

Investing For Good is assisting Scope to become one of the first UK charities to enter the capital markets. It is piloting a £20 million bond programme operating similarly to corporate bond products and listed on an exchange in Luxemburg.

Triodos Bank is assisting the community interest company Bristol Together plan a bond issue worth £1.6m. The first £600,000 was bought by a Foundation and the second tranche of £1m will be sold to private individuals to attract Community Investment Tax Relief, which allows investors to reduce their tax bills by 5 per cent a year for five years.

In some cases, investors may also receive the repayment in non-monetary terms, such as the goods and services provided by the enterprise. This segment of the market is still evolving, and new varieties of charitable bonds are continually emerging.

List of Notable Social Investors

Acumen Fund - https://acumen.org/

Acumen Fund is creating a world beyond poverty by investing in social enterprises, emerging leaders and breakthrough ideas

Allia - www.allia.org.uk

Allia is a charitable social investment intermediary that creates investment vehicles to raise finance for organisations delivering social impact.

Ashoka - www.ashoka.org

Ashoka is leading a profound transformation in society. In the past three decades, the global citizen sector, led by social entrepreneurs, has grown exponentially. Just as the business sector experienced a tremendous spurt in productivity over the last century, the citizen sector is experiencing a similar revolution, with the number and sophistication of citizen organizations increasing dramatically.

Big Issue Invest - https://www.bigissue.com/invest/

Big Issue Invest is the social investment arm of The Big Issue. Our mission - to dismantle poverty and inequality by investing in business solutions to social and environmental challenges.

Big Society Capital - bigsocietycapital.com/our-approach/social-lending/

Social impact investment can help support a wide range of organisations to access affordable finance in some of the most disadvantaged communities. From small loans to charity bonds, social lending can help enterprises grow their trading income, provide working capital, and increase resilience. Information about 23 different social lending funds.

CAN - www.can-online.org.uk

CAN support social enterprises and charities to scale up their businesses and maximise their social impact. We provide business support and capital as well as running CAN Mezzanine, high-quality and affordable office space exclusively for the social sector.

Charity Bank - www.charitybank.org

Charity Bank finances social enterprises, charities and community organisations, with the support of depositors and investors who want to use their money for real social change.

Coop and Community Finance - www.coopfinance.coop

Cooperative and Community Finance provide sympathetic loan finance to help people take control of their economic lives and create social benefit.

Deutsche Bank - www.db.com

Our social projects aim to help people help themselves, whether individually or in local communities. Deutsche Bank uses its global networks and expertise as a financial service provider to give people a chance to overcome unemployment and poverty.

Esmee Fairbairn - http://www.esmeefairbairn.org.uk

Esmée Fairbairn Foundation was established in 1961 by Ian Fairbairn as a memorial to his wife Esmée. Today it is one of the largest independent grant-making foundations in the UK.

Fredericks Foundation - www.fredericksfoundation.org

Fredericks Foundation is a charity that helps disadvantaged people set up, or expand their business as a means to achieve financial independence while rebuilding their confidence and self esteem.

FSE Group - www.thefsegroup.com

The FSE Group is an independent not-for-profit Community Interest Company whose purpose is to deliver growth funding and support to SMEs (Small & Medium Enterprises)*. The FSE Group delivers all regulated activities through FSE Fund Managers Ltd, a 100% owned subsidiary which is authorised and regulated by the Financial Services Authority.

Impetus Fund - www.impetus.org.uk

Impetus Trust works to break the cycle of poverty by investing in ambitious charities and social enterprises that fight economic disadvantage. We use our highly effective venture philanthropy model to accelerate the growth of carefully selected charities and social enterprises so they can help many more people living in poverty.

Investing for Good - www.investingforgood.co.uk

Investing for Good mobilises investment capital to tackle major social issues. Our innovative Charity Bond Programme allows charities and social enterprises to access mainstream capital markets. We also offer advice, analysis and reporting to private banks, asset managers, foundations and individual investors focused on the social impact of their investments

NESTA - www.nesta.org.uk

Nesta is an independent charity with a mission to help people and organisations bring great ideas to life. We do this by providing investments and grants and mobilising research, networks and skills.

Princes Trust - www.princes-trust.org.uk

We give practical and financial support, developing key workplace skills such as confidence and motivation. We work with 13 to 30-year-olds who have struggled at school, have been in care, are long-term unemployed or have been in trouble with the law.

Social Business Trust - www.socialbusinesstrust.org

SBT believe there are a number of social enterprises capable of scaling up their operations on a regional and national level and have goal: to help transform the impact of social enterprises and thereby improve the lives of over a million of the UK's most disadvantaged people.

Social Investment Business: - https://www.sibgroup.org.uk/funds

Social Investment Business runs several funds including the Recovery Loan fund and the First Steps Enterprise fund.

South West Investment Group - www.southwestinvestmentgroup.co.uk

South West Investment Group Limited is a not-for-profit making company and all its monies and any return on its monies are used to achieve economic prosperity through the provision of risk capital investment to businesses in the South West

Triodos Bank - https://www.triodos.co.uk/

Triodos is a global pioneer of sustainable banking. Our mission is to make money work for positive social, environmental and cultural change.

Unity Trust Bank - www.unity.co.uk

Unity Trust Bank brings you a fresh approach to banking. As a specialist bank for civil society, social enterprises, CICs, councils, and trade unions, we support our customers with socially-responsible banking services. And because we're a social enterprise too, we really understand the sectors our customers work in.

Unltd - www.unltd.org.uk

UnLtd's mission is to reach out and unleash the energies of people who can transform the world in which they live. We call these people social entrepreneurs.

Venture Bridges - www.bridgesventures.com

Bridges Ventures is a sustainable growth investor whose commercial expertise is used to deliver both financial returns and social and environmental benefits. We believe that market forces and entrepreneurship can be harnessed to do well by doing good.

Crowdfunding:

Crowdcube - www.crowdcube.com

We want to give entrepreneurs the opportunity to take control of raising funding from their own network of friends, family, customers and strangers. We also want to give ordinary people the opportunity to become an armchair Dragon and build their own investment portfolio supporting exciting new British businesses.

Indiegogo - www.indiegogo.com

Everyone should have the opportunity to raise money. Now everyone does. People all over the world use our industry-leading platform to raise millions of dollars for all types of campaigns. No matter what you are raising money for, you can start right now with no fee or application process.

Kickstarter - www.kickstarter.com

Kickstarter is a funding platform for creative projects.

Kiva - www.kiva.org

Kiva lenders combat poverty daily by making small loans to borrowers around the world. We believe in fair access to affordable capital for people to improve their own lives.

Funding Circle - www.fundingcircle.com

Funding Circle is an online marketplace to help businesses find finance, and investors get better returns. There are no middlemen, no banks, and no lengthy delays. It's an open exchange with information, empowering you to choose the best deal for your needs.

Contact us

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