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Creative finance: funding the future of social enterprise

Ten years ago, it was not fashionable for social enterprises to take loans. Even if they wanted to, nobody would lend them money.

This was because of the 'not-for-profit' perception as the term is associated in the minds of many with charity. If social enterprises are not making profits, how can they repay their loans? Also, social enterprises were perceived as not being well-managed and commercially-minded enough. Social enterprises themselves were afraid to borrow, especially since they were being charged relatively high interest rates.

However, perceptions are changing. In recent years, 'not-for-profit' has been pushed to the back partly because of responsible lenders and social enterprises are being run more like businesses today. Nowadays we talk about a need for 'surplus' rather than 'profit' to plough money back into the business and grow it.

Hans Wahl, the executive director of INSEAD's Social Entrepreneurship Programme, believes the trend has changed because there is more lending, largely because there are more vehicles better suited and more tailored to the needs of social enterprises. "The people offering these products are more knowledgeable about the field. The same is true from the demand side as well, when in the past they used other tools such as borrowing against property or other equity."

Social investment vehicles

In the last five years, the UK has seen the emergence of a number of small social investment intermediaries such as Venturesome, Big Issue Invest and Bridges Social Entrepreneur's Fund, offering a range of investments to social sector organisations from unsecured debt to equity and quasi-equity.

In response to this availability of capital, social sector organisations are increasingly considering using investment to fund their growth and innovation. "This is incredibly positive as it enables grant finance to be focused where it is most needed. Those that can repay investment do, meaning capital can be recycled, thus generating much greater social impact," Toby Eccles, founder and development director of Social Finance told INSEAD Knowledge on the sidelines of Voice10, the Social Enterprise Coalition's annual conference held here recently.

"We also see many social sector organisations struggling to persuade their conservative boards to consider investment approaches, struggling to understand what form of investment would be most appropriate to their needs and struggling with how to communicate most effectively with potential investors," adds Eccles. "This suggests a need within the sector not just for increased availability of capital, but also for increased availability of investment readiness and advisory services. Organisations like Social Finance are attempting to bridge this gap for organisations seeking to raise capital at scale (of more than £2m)."

So if access to finance is a key factor in ensuring the continued growth of the social enterprise sector, what options are out there?

Bridging loans

John Kingston, the director of Venturesome, the Charities Aid Foundation's social investment fund, noticed that whenever he drove past a church or a community centre, there would often be a thermometer outside showing the amount of money the organisation has raised. But he has never seen the 'mercury' reach the top. That was how Kingston started in social investment -- when he needed money for a building project.

"I worked out 10 years ago that we would never get to the top of the thermometer outside the church and we just need to borrow to bridge the gap. To bridge the fund-raising is actually quite sensible."

An organisation in Notting Hill, West London, had a £1.5m project to convert a church into community space. "The organisation raised about one-third of it and we worked out with them how to raise the rest. But they needed something to bridge from where they were to have enough money to sign the building contract with confidence and that's where we stepped in," says Kingston.

Another example is Questscope which does charity work in Jordan with young people and gets funding from the World Bank. However, the funds come in three to nine months late. In the meantime, they need to pay salaries and overheads, so Venturesome lends them money to bridge the cash flow.

In another model, the risks and the rewards are shared. Charity Technology Trust (CTT) acts as an intermediary between IT companies such as Microsoft and social enterprises. "CTT wanted to grow the company very quickly. So we put in money on an equity-like basis. If the business didn't work, they owe us nothing. If it did work according to the plan, we got our money back. And if it worked extremely well, we got twice our money back," says Kingston.

Mutual aid

London Rebuilding Society (LRS) is a community development finance institution which targets the most socially deprived, financially excluded communities in Greater London which are "viable but not yet bankable."
Naomi Kingsley

LRS' Mutual Aid Fund scheme is a unique model, having elements of a credit union, microfinance and wholesale finance. "What we've done is to take the idea of credit union from individuals and created it for organisations," says Naomi Kingsley, LRS' chief executive.

The focus is on enterprising micro groups which want to transform their own, and the community's, circumstances but can't access any finance.

The organisation buys shares in LRS and the shareholding becomes an asset on its balance sheet. LRS trains the organisation to be a micro lender so they can lend to their members.

"When they are ready to borrow from us, we lend them in multiples against their shareholdings. If they can save £10,000, we lend them £40,000," says Kingsley. "After five years, they begin to pay back the capital. The principle is to show that that mechanism works for them, so that potentially they can move on and raise that money from a different source or we will refinance it if they put in enough money themselves."

"It's really taken hold now with micro and mini social enterprises and a whole range of activities operating at a level that we can't reach," she adds.

The scheme is so successful that the African diaspora is now remitting money back home, not for consumption purposes but to replicate the model.

Social bonds

Social Finance has developed Social Impact Bonds (SIBs) as a new way of bringing extra money into public services to tackle long-standing problems. This has the potential to encourage innovation, tackle social problems at their roots and overcome budgetary constraints in the public sector.

SIBs work by identifying the savings that government would make from achieving a particular social outcome, such as lower levels of crime. In anticipation of the resulting savings, capital is raised from social investors and then used to meet the costs of services needed to deliver the desired outcome. If successful, investors receive a proportion of the savings that the government makes.

"Social Finance is currently working with the Ministry of Justice to develop a pilot Social Impact Bond targeting a reduction in reoffending among short-sentence prisoners which we hope to launch later this year," says Eccles.

Finding what works best

Social investment approaches offer a way for social organisations with assets and/or defined income streams (contract or retail) to scale their impact and better serve their clients.

Different organisational structures, business models and business maturity will require different investment structures. "Social entrepreneurs should research the range of financial products on the market and, if possible, take advice before making a decision as to what will work best for them," advises Eccles.

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