Challenges and opportunities in social finance in the UK

About Cicero Group

Cicero is an international consultancy specialising in corporate communications, digital strategy, government affairs and thought leadership generation for policy, business and consumer audiences.

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Challenges and opportunities in social finance

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About this report

This report has been written with the aim of examining the burgeoning UK social finance sector, identifying the challenges it faces and the opportunities it presents.

Drawing on in-depth interviews with experts from the sector, the report discusses whether changes are needed in areas such as regulation and government involvement to ensure that social finance continues to flourish.

It also investigates the central role that social finance could play in financial markets in the future.

What is social finance?

Social finance incorporates a number of socially-orientated financial activities:

- Impact investment - investing for both a financial return and a social return
- Social banking – investing deposits in social enterprises
- Charitable banking - banking with a specific focus on the needs of charities
- Providing banking services and advice to financially excluded individuals
- Crowdfunding platforms for funding social ventures

It is useful to note that on a spectrum of investment types, social finance sits between philanthropy and socially responsible investing. Given its focus on ensuring that its services positively impact on society, social finance also shares some characteristics with microfinance.

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Foreword

To what extent should banking be a metaphor for how our society works? Should finance be run like a business in the interest of its shareholders? Or is it such a significant wealth provider that it must or should be done in the social 'good'?

We have come to learn the hard way over the past few years about the importance of how our banking system works. As some of our most famous institutions teetered on the brink, we learnt that many of these 'wealth creators' were only in it for themselves.

Adam Smith's 'invisible hand' – the mysterious force that steers the selfish economic decisions of individuals towards a result that leaves us all better off – was hijacked to become one monumental slap to society.

Yet this does not make Smith or capitalism irrelevant. For Smith, one of The Enlightenment's greatest thinkers, capitalism was a source for good. The most important factor that has been neglected in recent times is our sympathy for one another – something which was in short supply, judging by the conduct of several financiers.

In a climate of heightened regulation and the government's deleveraging of balance sheets, this could be the opportunity to reshape how the world of finance works. Could social finance really fill that gap?

This report highlights how eight million individuals in the UK don't have access to mainstream credit, so why is this market yet to take off?

Uninformed consumers, a fragmentation of ideas and to some extent a lack of return on investments are just some of the reasons suggested by commentators in this report as to why social finance is lacking that cutting edge.

What is needed is to develop and deliver a simple message, as well as the creation of a platform to not only attract the investment, but also the brightest minds and expertise for the sector to flourish.

What did Smith think? He preached that free, competitive markets can be powerful forces for prosperity and for good.

But remember, markets don't exist free of societies and moral sentiments.

It is almost certain he would have approved of social finance.

Iain Anderson
Director and Chief Corporate Counsel
Cicero Group

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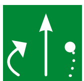
Executive Summary

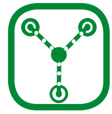
Challenges

- The social finance sector is being held back by a lack of awareness, with many potential stakeholders unacquainted with the opportunities that exist within the sector.
- There is fragmentation within the sector due to the different agendas of stakeholders.
- There are practical challenges arising from a lack of communication, both from within the social finance sector, and between the sector and mainstream financial services, corporates, the charitable sector and the public.
- Growth in the sector is being stifled by the lack of quantitative examples of successful social finance projects, which is preventing investors from pricing risk.
- The sector is currently unable to effectively measure social return and stakeholders are split on how this should be done.
- Charities and social ventures tend to struggle with progressing to a more commercial approach and are often unprepared to receive investment.
- There is a lack of funding for organisations that provide advice, and work to develop the investment readiness of social organisations.
- Existing regulation thwarts risk-taking by high net worth investors.
- Stakeholders disagree as to whether the sector needs to be supported by new legislation or whether existing laws should be adapted to boost development, but improved tax incentives for social investors are favourable.
- The social finance sector currently struggles to produce desirable returns for investors.
- High start-up and regulatory costs could prevent mainstream banks from entering the sector.



Proposed Actions

- Relationships within the sector need to be improved, with stakeholders encouraged to build strong alliances with mainstream providers, the public, corporates and the media, including those based overseas.
- The sector needs to standardise products to help with consistency and data comparability.
- Formulating better networks is crucial to the growth of the sector, in terms of both angel investors and individual retail investors.
- Direct investment by intermediaries, angel investors and foundations could stimulate growth in the sector, shifting social finance towards the mainstream.
- The development of a larger market for retail investors would draw additional capital into the sector, but disintermediation may be necessary due to risks arising from data misalignment and product misselling.
- Charities and social enterprises should be making social investments as part of a social economy.
- The sector needs to better attract talent, specifically individuals who have gained relevant expertise in finance or those at an early stage in their career.



Looking forward

It has been suggested that, in time, social finance will become inherent to the practice of investing in line with the progression to a conscious economy, however the sector first needs to establish itself. Leading commentators in the field expect this development to take between two and 10 years.

"Within every difficulty lies opportunity"

Albert Einstein

Introduction

The ability of capitalism to boost economic growth and increase living standards across the globe has been widely acknowledged, but what about its ability to 'do good' in areas of our society that have been left behind?

As stability across the globe continues to waver, with frequent political changes, sovereign debt crises and a rise in public frustration and distrust, there is a growing acknowledgement that alternatives to the current financial and business systems should be explored and analysed. Demand for the development of a more resilient and sustainable system, driven not by the need for excess profit but sustainability and humility, is being echoed across the globe.

In the UK, a potent mix of the economic aftermath of the financial crisis and heightened regulation has resulted in mainstream financial institutions struggling to support the stuttering economy. At the same time, the government continues its attempt to reduce the deficit at a rapid rate, while simultaneously hoping to deliver economic growth.

Funding gaps are therefore not only evident in the private sector. The need for public services is increasing and meanwhile public expenditure cuts are set to create a substantial hole in the balance sheets of charities, many of which are scaling up their operations and innovating to meet demand in new areas. Against this funding shortfall, philanthropic donations from the public and other sources are unlikely to be enough to fill the gap left by a shrinking public sector.

Social finance might just prove to be part of the answer.

Defined as the 'provision and use of finance to generate social and financial returns,[i] and aided by the rise of the social entrepreneur, social finance sits between grant-making and 'socially responsible investing' - home to familiar environmental, social and governance filters. Investors in the field are looking not only to receive a return on their capital, but also to see that their money has an impact in terms of tangible social change.

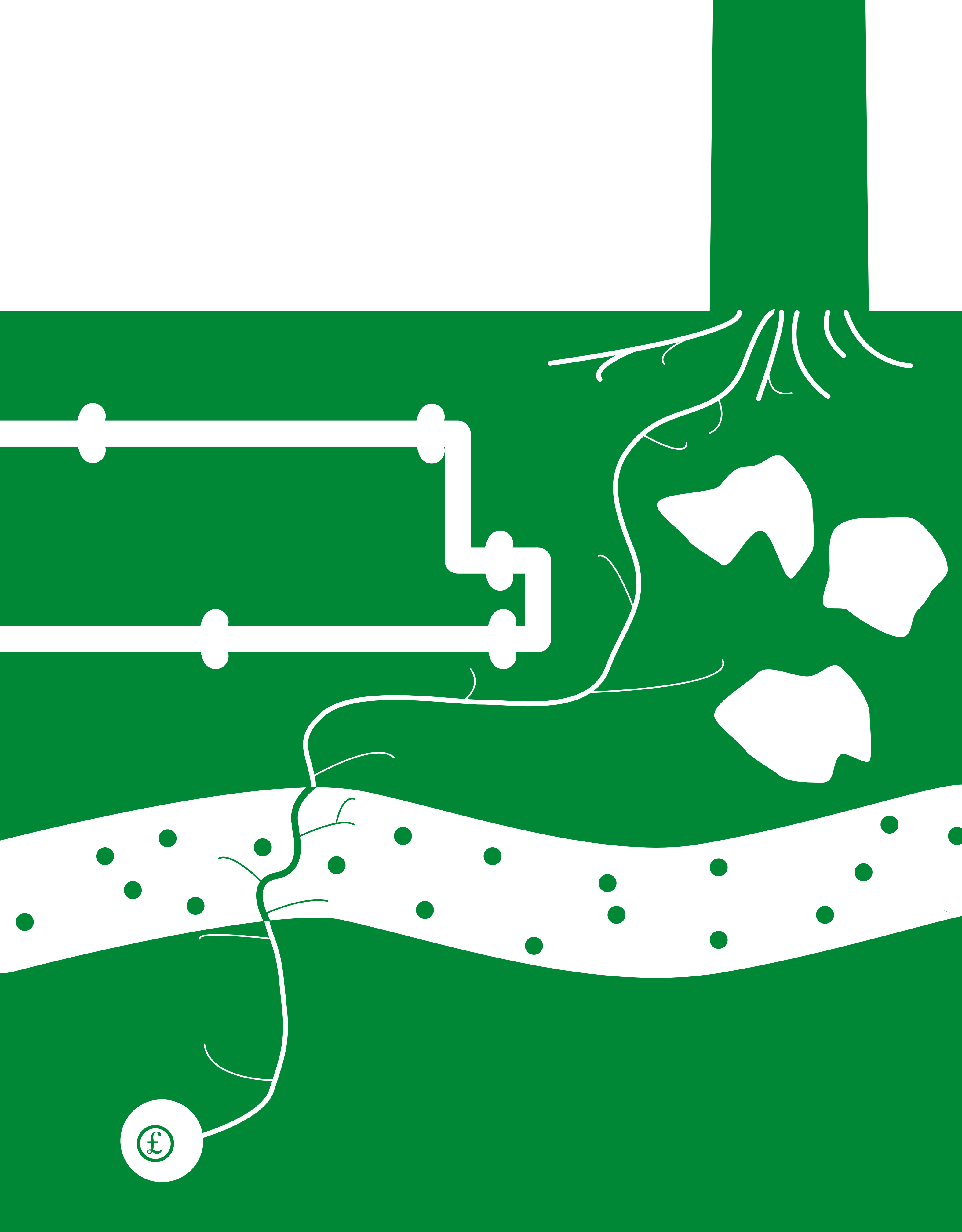
Having developed gradually over the past decade, individuals and organisations are now attempting to develop a proper structure to provide clarity within this budding market. Intermediaries in the sector are looking to mobilise investors to provide charities, social enterprises and entrepreneurs with a range of sustainable credit options. As well as building new institutions in the space, market participants are designing new instruments in order to finance solutions to social problems and to offer socially-orientated services.

Additionally, provisions exist catering for retail investors. Much as microcredit evolved from a focus on loans to 'microfinance' encapsulating the provision of banking services, the social finance sector has seen the development of products for the day-to-day investor. In response to deep-rooted hostility and concerns about the mainstream models for banking and investment, ISAs and retail trading platforms have emerged to provide a new

and alternative investment proposition to the many whose trust in their banks and the destination of their money has dwindled. Aside from these offerings, the social finance sector has started to tackle the challenges surrounding financial inclusion for the approximate eight million individuals[ii] in the UK who, despite living in one of the richest countries in the world, remain 'unbanked' or unable to access mainstream credit.

At a central level, the government has been quick to recognise the potential for social finance to cut costs and provide an efficient means of tackling issues such as Britain's ageing population, sustained unemployment and the need for a low carbon economy. Following on from UK Prime Minister David Cameron's Big Society campaign, Big Society Capital, an independent financial institution that is regulated by the FSA, has taken a main stake in the sector as a cornerstone investor. In addition, the birth of the Social Value Act, which places a duty on public bodies to consider social value ahead of a procurement, as well as increased approaches to social projects, indicates increased reliance on social organisations to deliver services and contribute to growth. Across all political parties and departments, MPs and civil servants are aware that as the government's ability to fund public services declines, social finance is a useful vehicle for investment. The sector can offer both preventative measures and current services to build a society that not only copes with the consequences of this funding gap, but also prepares itself for the challenges of the future.

This report provides an insight into a number of the discussions Cicero has had with individuals and organisations in the sector, including mainstream banks, charities, social businesses, social finance intermediaries and academics. The report examines the obstacles that the sector faces and provides suggestions from those in the sector of how to overcome these challenges.



Section One

Challenges

It is clear that social finance faces a number of challenges which are potentially stifling the sector's growth. These challenges range from a general lack of knowledge about the sector's activities and potential, to technical obstacles such as the need for more substantive data on past and current social finance products.

It is also apparent that some challenges will require longer term solutions than others; communicating the potential of the sector is perhaps easier to tackle in the short term than reducing fragmentation among different parts of the sector.

Awareness and definition

Arguably, one of the biggest challenges social finance faces is a distinct lack of awareness about the sector, both in terms of the activities already taking place, and the opportunities it presents.

Due to the language used by the sector and difficulties with investor accessibility, there is some confusion around the trade off between social return and financial return. According to Jo Hill, interim director of ventures at UnLtd, a charity that supports social entrepreneurs, the melding of the two distinct areas of investment and social impact causes difficulties. Bates Wells & Braithwaite LLP senior partner Stephen Lloyd adds that financial language and structures can often be confusing for people who do not have a background in financial services, while those in the City can find a social approach difficult to comprehend, and may not see the benefit of investing if there are no demonstrable returns.

Senior decision makers in the corporate sector often have a limited comprehension of social finance, according to Steve Wickham, director of The Giving Department, which is a specialist corporate social responsibility consultancy.

"There isn't in my mind a conversation that is going on in the boardroom or in the CSR departments of companies that I am aware of," says Wickham.

"They are certainly not calling me up and saying, 'why are we not putting some of our budget towards something of this nature?'."

A lack of understanding from the public also impacts upon the demand for social products, meaning mainstream banks have been slow to offer these services. Peter Mitchell, chief executive of Charities Aid Foundation Bank, says that there needs to be a shift in the perception among consumers to ensure they understand the value of their deposits to generate institutional product offerings.

Tom Rippin, chief executive of leadership programme On Purpose, argues that there is an assumption within the sector that the general population knows more about social finance than it actually does. More needs to be done to educate the public, he says, arguing that the sector lives “in a bit of a bubble”.

But the lack of a clear and commonly understood label for those outside of the sector is not without reason. Sometimes defined as ‘impact investment’ in the US, and also known as ‘social investment’ or discussed as part of a ‘social economy’ in Europe, the sector’s nametag still defies definition. David Hutchison, chief executive of social investment intermediary Social Finance Ltd, says he defines social finance as investing capital to create social change.

> “This is a way of investing ultimately, not a type of investment and that means a whole different approach.”

Hutchison says: “You are looking to support organisations or entrepreneurs who are making a positive contribution to society and allowing them to grow. That means mobilising investors, who are very keen to drive social impact, while at the same time having a reasonable expectation of financial return.”

However, some commentators believe that even participants in the sector are confused as to how social finance should be defined. Among them, Malcolm Hayday, former chief executive of Charity Bank, says the sector needs to be more consistent when using terminology surrounding social finance in order to prevent misunderstanding.

Currently, he says that social finance consists of a number of initiatives that overlap, rather than these initiatives clearly identifying their place in the market.

Graham Allen, MP for Nottingham North, says social finance can be hard to define because it is still developing as a sector, with new products and services continuing to emerge.

However, some commentators argue that to accommodate the fledgling nature of the market, broader definitions are useful as they provide more accessibility for investors and the public. Karl Richter, fellow at the Finance Innovation Lab - a network designed to inspire change in existing financial systems - says he appreciates flexible definitions will cause “fuzzy boundaries” that need managing, but argues that this can build a wider appreciation and understanding of social finance.

“This is a way of investing ultimately, not a type of investment and that means a whole different approach,” says Richter.

“It is about the pluralism and the diversity in this market.”

The set of activities and types of finance included in the social finance space are also hotly debated. Tim Jones, chief executive of social profit society Allia, outlines a number of points where confusion often arises.

“Do you mean investments that are ethical, that don’t invest in drugs or weapons?” he asks.

“Do you mean positive selection, which means investing in things which only do public good? Or do you mean funding civil society? Do you mean social wellbeing in general?”

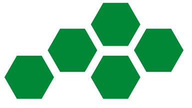
In the US, the term social finance includes a range of activities, from responsible investing to specifically financing enterprises that deliver social benefits as well as new financial instruments that help to fund social progress, explains Mark Kramer, chief executive of non-profit consultancy FSG Consulting.

There is also a wider debate as to whether the sector should be considered an asset class. David Hutchison of Social Finance Ltd argues that this is an unhelpful way of looking at the sector as these products and businesses will often “cut across asset classes” such as property, bonds and equities.

It has been suggested that in parallel with the diversification of microfinance from loans into banking products, the social finance sector should include services that are specially designed for the approximately eight million people who are unable to access mainstream credit. According to Alastair Davis, chief executive of social finance intermediary Social Investment Scotland, financial inclusion has to be considered a crucial part of the social finance sector.

“If we’re talking about economic growth and the development of communities, money makes the world go round,” he says, explaining that access to credit is particularly important in driving social change.

But Bertrand Beghin, founder and director of consultancy Numbers4Good, argues that serving financially excluded individuals is more of a “social delivery”, as opposed to social finance in itself.



Fragmentation

Due to the organic nature of how social finance organisations have developed in response to market failures, there are a number of players in the sector with different strategies and perceptions of how social finance might develop.

To ensure that organisations within the sector are cooperating to share similar goals, instead of potentially working against one another, Charity Bank’s former chief executive Malcolm Hayday raises the question as to whether a proper framework needs to be developed.

But UnLtd’s Jo Hill argues that while the sector is currently “hard to navigate”, experimentation is inevitable. She is optimistic that over time, organisations will move towards a more coordinated approach. Her view is shared by Danyal Sattar, finance fund manager at Esmée Fairbairn Foundation, who says that this process of researching the market, identifying opportunities and developing products will take time.

Graham Allen MP argues that cohesion is crucial before competition heats up. He explains that social finance can only become more competitive once there is a thriving sector, but that currently the sector needs to define “what the goods are and how it would work”.

“Then by all means let a thousand flowers bloom,” he adds.

Other commentators believe that because there are already a large number of providers and investment opportunities in place, more patience is needed from stakeholders before the sector can take off.

"Too many people are trying to get things back before they've built the market," says Faisel Rahman, founder and managing director of Fair Finance, a loan provider to the financially excluded.

With 90 per cent of the market controlled by just six social finance intermediaries[iii], Rahman is also concerned that some areas of the market are already inflexible.

"I suppose what is a bit frustrating is that there are lots of people who believe everything is still to play for, and then there are lots of others who are already stuck in the model that they haven't figured out whether the sector really needs or not," explains Rahman.

> "With 163,000 charities, thousands of companies and dozens of government departments, the average man on the street, which translates to the person in the boardroom, is completely foxed by the whole thing."

Additionally, some commentators note that the sector's agenda should not become focused on social finance becoming a replacement for public funding. Jamie Hartzell, managing director of retail investment network Ethex, notes that "there is nothing more fickle than politics". He fears that funds backed by the government could be withdrawn from social projects if government policy changes in the future.

On Purpose's Tom Rippin advocates diversity in the sector, arguing that "trying out an experiment in lots and lots of different ways is no bad thing". He explains that certain models will emerge as being more successful than others, allowing a blueprint for the sector to emerge "almost organically". But he says that for now, trying to impose or even identify a "right way" will not be helpful.

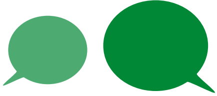
But this view is not replicated across the social finance sector. Steve Wickham, Director of specialist CSR consultancy The Giving Department, believes that fragmentation affects the sector's ability to engage with corporates and mainstream financial institutions.

Wickham says: "With 163,000 charities, thousands of companies and dozens of government departments, the average man on the street, which translates to the person in the boardroom, is completely foxed by the whole thing".

He says that because there are a variety of investment choices, the sector needs more collegiate working between government, social finance intermediaries and corporations.

"The conversation at the moment hasn't really got a home," he says, noting that the government, charities and companies' CSR departments all have different agendas.

"The forums in which they all meet are few and far between," adds Wickham.



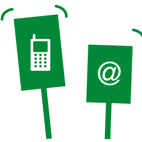
Communication and engagement

The current lack of unity within the social finance sector is also creating practical barriers for investors, according to Bertrand Beghin of Numbers4Good.

“Social enterprises today are saying that they can’t find investors or grant-makers and aren’t getting any money. On the other side you have funds, but they can’t find any investment-ready projects. There is a gap,” he says.

There is also an issue with the eligibility of social enterprises, according to Bruce Davis, co-founder and retail director of online investment platform Abundance. Davis says some funders have so many rules in place about investing and donating that they “can’t give anybody any money”.

Relationships with mainstream financial providers such as banks and hedge funds also need to be developed. Geoff Burnand, chief executive at intermediary Investing for Good, explains that while engagement with the mainstream financial services sector is getting better and tangible conversations with senior individuals are taking place, “it has to move beyond a CSR initiative”, given that the financial services sector could “gain enormously” from the experience and expertise of the social sector.



Demand for social banking products

In order to create a greater number of social finance products, increased demand from the public is crucial. But Peter Mitchell of CAF Bank is fairly pessimistic about the reality of a mass shift towards these products taking place, noting that people are “incredibly conservative” with regard to switching their bank accounts. He cites that around 90 per cent of people choose to stay with the bank where they opened their first account.

Other commentators believe that the lack of demand for social products is because the average person is not yet ready to put charitable giving and investments into the same sentence.

In particular, former Charity Bank chief executive Malcolm Hayday says: “I think we are fooling ourselves if we believe that everybody will want to be a social investor.”

However, Tom Rippin of On Purpose argues that this indifference is preferable over a mass shift in behaviour. He says that the sector needs to be wary of creating a “bubble of expectation” if it is not capable of dealing with a large amount of investment. If investors flock to the sector and do not see immediate returns, “then in five years’ time, they’ll go ‘that didn’t really work’ and pull out”, he claims.

Precedent

As a nascent market, one glaring problem the sector faces is the lack of a track record. According to Fair Finance's Faisal Rahman, social finance is currently a sub-prime market.

"If you think about it, the market that social finance works in is untried, untested, different, odd, lacking data, with not very many successes but a lot of noise," he says.

With the market at its earliest stage of development, it is likely to face difficulties in raising finance, much like small businesses often struggle to find capital, according to other commentators.

Additionally, only a narrow basket of products exist that investors can actually purchase, impacting on the ability to attract co-investors. Esmée Fairbairn's Danyal Sattar argues that while the launch of Big Society Capital and the migration of trusts and foundations into the space is a positive development, the sector needs to create more products, and build credibility around these offerings, before more mainstream providers move into the social finance space.

Rahman says the main problem is that mainstream institutions are yet to see enough successful commercial transactions.

"It is not that they [financial institutions] price themselves out of the relationship, it is that they have to assume that every single one is going to fail, and price for that failure," he says.

Other than "very small examples" there is not a model of success in the personal finance, advice or housing spaces, adds Rahman.

A number of commentators highlight that social finance will continue to be perceived as a fringe sector until there is more evidence that it is an investment and not simply a gesture of goodwill. Jo Hill of UnLtd argues that the more examples that are produced, the more people will see that social finance is not simply a form of philanthropy but that it has a viable return and can be part of a portfolio of investments.

The small number of deals that have been completed in the sector also negatively impacts on the cost of capital, according to BWB's Stephen Lloyd.

"It is difficult to create new products because the market isn't mature enough to sustain the volumes which would help to cover the financial transaction costs," Lloyd says.

Case study: Deutsche Bank

Tiina Lee, head of UK strategy at Deutsche Bank, says the firm had to create its own benchmarks when establishing a fund of funds in 2011.

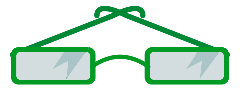
"The very first thing that I did in being tasked with seeing the viability of setting up a fund was to say 'What is out there? Are there any best in class, large institutions that have been investing in this space?'.

"Even though there had been other financial institutions that had committed £1m here or there, what was very clear was that in most cases, the chief executive thinks, 'fantastic, sounds like a brilliant idea, here is £1m', or it comes out of a random budget, depending on the institution. There wasn't really any best in class example that we could look to and say 'that is how we want to create a fund'."

Part of the solution to developing a stronger track record for the sector lies in attracting new social enterprises to the market, according to Joe Ludlow, impact investment director at innovation charity Nesta. He calls for innovative business models to enter the sector in order to increase competition between the current players.

The retail space is also negatively impacted by a lack of track record. Sattar explains that IFAs struggle with the lack of benchmarking and says that charities need templates. "For a charity which has not raised those investments and doesn't have those skills, they will need examples to look at to get confidence that this is a way forward," he says.

In terms of attracting corporate interest, Steve Wickham argues that the lack of a track record is the biggest barrier to growth for the sector. He argues that it is "hard enough" to ring-fence a CSR budget without raising questions about the viability of investing in something more "cutting edge".



Visibility

Problems also exist in attracting mainstream capital into the sector because of a lack of visibility around data and returns. According to Fair Finance's Faisel Rahman, "nobody has that type of track record of significant rigour, of significant analysis, to be used as anything resembling an asset class".

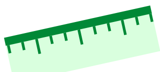
As a result, mainstream institutions do not have enough information to understand and price risk, making it "very difficult" for them to analyse if expected returns will be sufficient. Because of this ambiguity, it is impossible for these social investments to be approved by banks' risk departments, Rahman says.

Given that banks will not advertise products that do not pass their internal risk management systems, Rahman says they will only consider offering these products under a different brand, if at all. "And that is expensive," he adds.

While steps have been made to enhance the visibility of data, such as the Royal Bank of Scotland's SE100 Index which details social enterprises, Rahman argues that there is still an information gap in the industry which is affecting the role of social finance intermediaries.

He says: "Because nobody has had a system that analyses the data effectively, we have ended up with individual organisations going to investors."

A lack of data can stifle the development of state-initiated investment opportunities. Graham Allen MP explains that in order to develop a public/private partnership around a social problem, a "really good" evidence base is needed with clear known outcomes, which can then be monetised.



Measurement

Although a central point of interest for social finance infrastructure is the measurement of social return, Mark Kramer of FSG Consulting highlights this as a particular area where the sector is struggling. Initiatives such as the Global Impact Investing Rating System are in existence, but Kramer notes that these are "certainly not widely used" and are often too complex.

Kramer says investors are at the stage where any socially responsible investment is "good enough" to fulfil their criteria of social return. However, investors are not currently comparing investments according to how much of a social impact they will have. Despite this, Kramer is optimistic that as the demand for funds becomes more competitive, it will be necessary for people to quantify their social returns more precisely.

Measuring the actual social impact is critical given that it directly affects investor appetite, according to Danyal Sattar of Esmée Fairbairn. Foundations need to know if the social impact of the investment justifies the trade-off of potentially lower or less guaranteed financial returns to ensure they keep investing, otherwise grants may be considered better value, Sattar says.

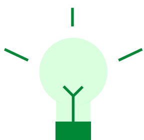
"If we are returning somewhere between zero and 3 per cent on our portfolio, and our mainstream benchmark is inflation plus 4 per cent - so that's 7 or 7.5 per cent at the moment, can we justify that give up? That 4 per cent, is that what we're getting a social return for?" he questions.

But David Hutchison of Social Finance Ltd, says that measurement is "in the eye of the beholder", meaning that it cannot simply be summarised by numbers or figures.

Instead, he argues that enterprises should articulate how the impact they claim to have is attributable to their activities.

"Some investors will find that powerful, some will not. It's very difficult to compare apples with oranges," he says.

Central to the concept that value and return are inextricably linked, The SROI network has launched WikiVOIS, a database designed to capture content on values, outcomes and indicators and how they are being used within the social finance sector, in order to create a consistent measurement of social return. However, the database is currently in its infancy and is limited by resources.



Commerciality, innovation and investment readiness

In the name of sustainability, there is a growing trend for organisations to turn social and environmental problems into business opportunities. But in line with their social focus, many lack commerciality and innovation.

Mark Sesnan, managing director of social enterprise Greenwich Leisure Limited, argues that a shift in approach is of fundamental importance. Social firms need to understand why and how investments take place and the returns that investors expect.

"A lot of the issue with socially driven businesses is that when they are mission-driven, they are not necessarily business-driven. You might have morals, ethics, value system and those things, but you are playing in the same marketplace as the rest of the capitalist world as far as attracting finance is concerned," Sesnan says.

Even if they are in a position to approach investors, many organisations struggle with the practical side of preparing for investment. CAF Bank's Peter Mitchell explains that while a number of organisations may be financially viable when it comes to looking at a loan, "the issue is the extent to which - from a governance, and a systems and controls perspective - they are actually mature enough to take that finance on".

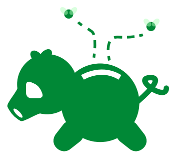
Sesnan agrees, saying investors must be aware that social organisations that have done well as small businesses might not necessarily translate that into success as large businesses.

Cultural changes also need to be accommodated before a social business can become investment ready. Staff and trustees of organisations that have been used to receiving grant funding need to be prepared for the changes that will accompany receiving actual investment.

> "Where you've got a charity which has been a charity since the year dot, how do you change that into something more commercial?"

Harriett Baldwin, MP for West Worcestershire and vice chair of The Social Investment Business, acknowledges the difficulties in accommodating this shift across the organisation.

"I think the tricky thing is where you've got a charity which has been a charity since the year dot, how do you change that into something more commercial?" she says.



Lack of funding for advisories

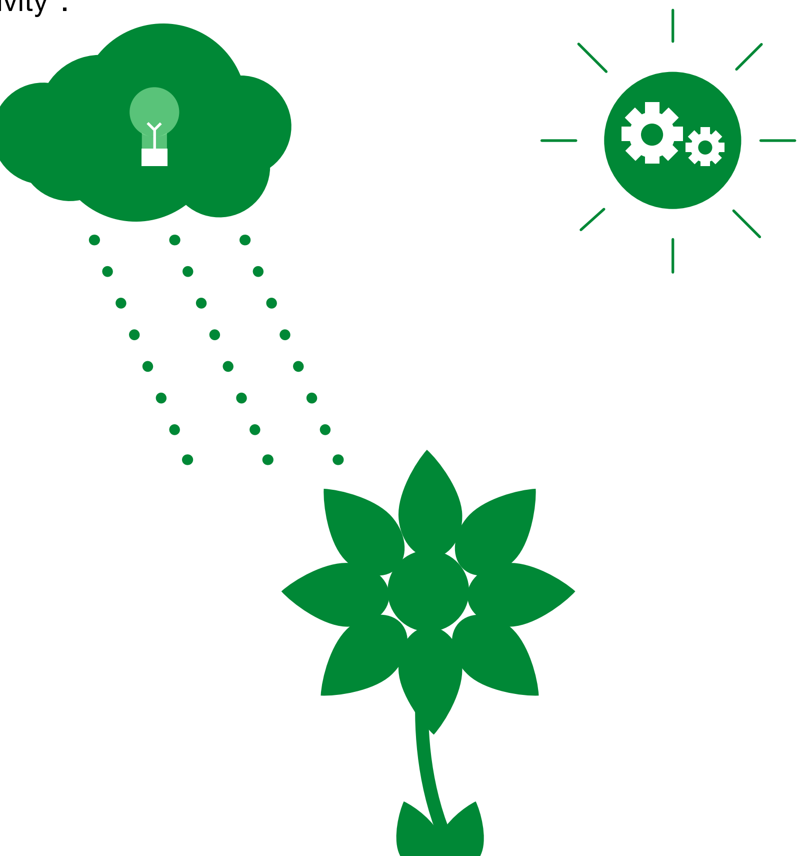
One of the main factors in poor investment readiness is the lack of expert advice available to social organisations, according to Nesta's Joe Ludlow. He says that intermediaries that focus on giving advice are the centrepiece to creating investible opportunities, but while their support is as crucial as the supply of money, "nobody is willing to pay for it yet".

Among the organisations unwilling to shell out for advice are the charities themselves, adds Steve Wickham of The Giving Department. Some may not have the money, while others are "philosophically disinclined", he says.

According to Social Finance Ltd's David Hutchison, as the size of the market grows and as the number of social companies seeking finance increases, "there will be arrangement fees that will help finance that kind of activity".

The way around this problem is for advisory organisations to have their own model of sustainability, according to Faisel Rahman of Fair Finance. As an example, Rahman says that landlords often lose out financially when tenants get into debt. Instead, Fair Finance offers an educational service to the indebted individual - paid for by the landlord - giving them the skills to manage their levels of debt and eventually repay the rent that is owed.

"We've innovated outside the philanthropy and taxation system to create a new market in this space. That is where social business can get interesting," Rahman says.



Regulation and legislation

Challenges around regulation are also the root of much discussion, with legislative restrictions commonly seen as preventing larger volumes of capital from migrating into the sector. The density of financial legislation means that innovation in the sector can be extremely difficult, according to BWB's Stephen Lloyd. This problem is heightened, Lloyd says, because social investment is a relatively new phenomenon, meaning much of the existing regulation and infrastructure "does not contemplate it or assumes it doesn't exist".

Finance Lab Fellow Karl Richter explains that regulation has an impact on the type of capital organisations are able to access.

"Charities by their very nature are not allowed to have private ownership of their assets [as] they are for public good," he says.

He highlights that because equity requires private ownership, charities cannot take on equity investment at all, although there are a number of ways they can work around this, such as by using intermediate capital.

"Debt can start behaving like equity, it can start taking on risk characteristics and risk profiles of equity," says Richter. He also explains that charities can set up wholly owned subsidiaries and issue shares to raise equity investment, but that it requires "sophistication" in how the charity is managed.

But BWB's Stephen Lloyd argues that even with arrangements such as the Revenue Participation Agreement, which entitles the holder to a percentage of annual revenue, revenue financing is still complex for social enterprises. He labels this as "another classic example" of innovative financial plumbing being stymied because "the regulatory word has not caught up".

But is the social finance sector really that different to mainstream businesses? Small businesses often have issues with raising capital and with the cost of these funds due to regulatory compliance, says David Hutchison of Social Finance Ltd. However he does admit that in the social finance sector specifically, investors are well-protected by regulation, therefore making access to the sector more difficult.

Stephen Lloyd highlights that a large part of the challenge to find suitable financiers is that the financial system does not facilitate the investor who wants to take risk.

"The way it is developing with the Financial Services Bill [currently in Parliament] is all about consumer protection, it is all about stability, avoiding misselling and managing risk," adds Lloyd.

As floated in BWB's report, 'Ten Reforms to Grow the Social Investment Market'[iv], Stephen Lloyd and associate Luke Fletcher argue that a short piece of primary legislation could help rally the sector. Similar to work in the US on benefit corporations, the report says that a UK bill could include, a social enterprise version of a limited liability partnership (known as an SELLP). In line with this potential development, the report advocates the conversion of the Community Interest Company Regulator to a Social Economy Commission - a body with the wider remit of safeguarding the social investment market.

To address suitability issues, the authors suggest that the UK could also reform financial promotion rules to create a specific authorisation regime for social investment, including peer to peer lending and crowd-funding regimes.

However, regulation needs to balance levels of transparency and innovation for social businesses, just as it does for mainstream firms, according to GLL's Mark Sesnan.

"While I think we have got to make sure there is openness, honesty and legality, we do not want to stifle innovative and maverick things either," he says.

But Graham Allen MP, who is the author of a number of government-commissioned reports on early intervention, argues that parliamentary bills are "fairly blunt instruments". Instead, he advocates a Treasury-based task and finish group to "really get its teeth" into examining how the sector is regulated.

A closer look at the retail market

Arguably, the area where regulation restricts activity the most is on the retail side of the social finance sector, with Jamie Hartzell of Ethex labelling the series of rules it has to abide by as "a massive issue".

"The Financial Services Market Act is a big one," he says. "There are also Money Laundering [Regulations] and the Small Payments Directive. There are layers and layers of regulation that investment could come under and anyone that wants a product wants to see their regulatory position."

Hartzell argues that there is too much regulation even for those that only want to invest small amounts of money. "If you invest £10 into a social business...you are subject to the same regulation as if you are investing £10m," he says.

Despite this fact, Hartzell stresses that he doesn't feel that a specific exception needs to be made for social businesses. He says: "If they [the government] lighten the regime, then a lot of people are going to come along and try and fit under that regime".

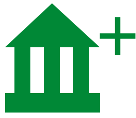
Nesta's Joe Ludlow explains that there are also concerns around the promotion of retail products due to the current regulatory environment.

"I can stop you on the street and ask for five pounds, but if I offer to give it back to you, I've made a financial promotion and that's the most regulated area of financial activity," he says.

Additionally, Ludlow argues that social finance ventures have to be extremely careful about seeing retail investors as a short term source of investment, given the destabilising impact that misselling these products could have on the sector.

"Having said all of that, there are certain places and certain opportunities where a fully regulated retail investment product will fly," he says, referring to the growing disintermediated retail market.

However, for Social Investment Scotland, the complexities involved with administration and regulation has resulted in the firm omitting the retail market from its strategy altogether, while Deutsche Bank's UK strategy director Tiina Lee explains that the bank is very wary of the retail market as there is no certainty that a retail investor would really understand what they are investing in.
She says: "The last thing one would want in a market that is so new, is to end up with some misselling scandal."



Should the UK government be doing more?

In its 2011 report, 'Growing the Social Investment Market: A vision and strategy', the government acknowledged that Britain needs a new way of tackling a series of stubborn and expensive social problems. But is it doing enough to grow social finance?

It certainly appears to be trying. In a progress update, published in July 2012, the government backed the potential of social finance, noting that growth in the sector is gaining momentum. Perhaps even more encouragingly, the report cited the importance of the government's central role in expanding the market, outlining the practical steps that are being taken to achieve this goal.

The update referenced Big Society Capital, the world's first social investment bank, launched with government assistance in April 2012, which is expected to make investment commitments of up to £50m by the end of 2012. It additionally acknowledged the development of a three-year £10m Investment and Contract Readiness Fund managed by The Social Investment Business and the possibility of launching a Social Incubator Fund, which would provide space, finance and advice to social venture start-ups.

In addition, the paper outlined commitments to work on improved procurement for social ventures through an Outcomes Finance Fund and announced that the government is establishing a Social Impact Bond Centre of Excellence to support the development of public private instruments.

Moreover, the report unveiled a new impact measurement programme, 'Inspiring Impact', to be overseen by think tank and consultancy New Philanthropy Capital.

Despite this progress, the sector feels that there is still more that can be done. In BWB's recent paper, 'Ten Reforms to Grow the Social Investment Market', referenced earlier in the report, Stephen Lloyd and Luke Fletcher call on the government to make social impact investment a theme of its impending G8 Presidency in 2013. Additionally, the pair also made the case for a new social investment commitment in the revised Millennium Development Goals.

In the report, Lloyd says there needs to be a new regulatory framework to accommodate social finance in light of a shift from "a binary world, where people have made a financial return and spent their money on social impact" to a "much more nuanced world". He also calls for a social investment duty to be placed on the Financial Services Authority and the subsequent Prudential Regulation Authority that will officially replace the FSA in 2013.

> "One way of addressing this profitability problem is to raise capital that is prepared to take lower return. Another way of addressing it is changing incentives in the market place."

Looking specifically at the retail market, Abundance's Bruce Davis highlights that there is currently an imbalance in legislation and he calls for better tax reliefs for individual retail investors. He explains that if the sorts of tax breaks that high net worth individuals receive were filtering down into the social retail market, this would curb retail demand from gravitating towards the FTSE, and instead provide opportunities for investment in the social finance sector.

Government incentives could also address the fact that social ventures are yet to produce strong financial returns, according to Nesta's Joe Ludlow.

"One way of addressing the profitability problem is to raise capital that is prepared to take lower return," Ludlow says.

"Another way of addressing it is by changing incentives in the marketplace."

Other commentators believe that social returns need to be considered in any changes to regulation. Legislation in the UK tends to focus on investment management and the raising of deposits, says Charity Bank former chief executive Malcolm Hayday, "rather than what you do with that money".

But while leading social investment and civil society organisations have called for the Treasury to consider the particular requirements of the social investment market in changes to financial regulation, The Finance Lab's Karl Richter argues that too many novel measures could be damaging.

"I don't think we need a whole new set of tax breaks or regulation," he says. Creating new legislation could leave the impression that by being "a very special case" the sector is also a potential basket case, in his view. Instead the government could help by expanding current tax reliefs while providing "stronger signals, guidance and indicators" to help bring together various stakeholders.

"They can also use legislation and regulation to shape the market. There will be a lot of negative opinions on that, but have the debate and see where it goes," Richter argues.

Within parliament, Harriett Baldwin MP argues that backbenchers could be doing more in terms of raising awareness. Additionally, she believes that local government has an "incredibly important" role to play in embracing social finance.

However, others believe that the sector needs to properly mature before policy options can be drawn up. Investing for Good's Geoff Burnand says: "There is a risk in this sector that we all talk a bit too much, and there needs to be a bit more experience around the investment flows in order to develop a fresh policy framework."

Cost and return

Arguably the greatest inhibitor to the growth of the sector is the cost of providing social finance products. Peter Mitchell, chief executive of CAF Bank, highlights that particularly for social banking, the scope for expansion is limited because providers are "not able" to harness the social value they aspire to as they are spending so much time using the return they make to manage risks.

Only mainstream banks may be able to ultimately stomach these costs, he says, while questioning if there is sufficient consumer demand for social bank accounts.

"My sense is that for the everyday man on the street, the attitude is 'return, or no cost for the service I want, I want it free,'" Mitchell says.

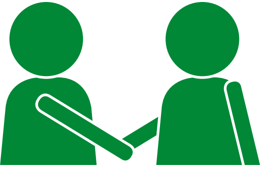
The so-called 'conscientious consumer' is actually a "very illusive beast", according to On Purpose's Tom Rippin. He notes that while many consumers will identify themselves as ethical savers in customer surveys, when it comes to actually cashing out at the till, "far fewer people do what they say".

Abundance's Bruce Davis adds that individual retail investors often "do not have the money to do good", meaning that social bank accounts still have to offer an attractive financial return for them to invest.

Recommendations from the sector

In order to tackle not only the number, but also the varying nature of the challenges the sector currently faces, it is clear that a combination of measures need to be put in practice to develop social finance.

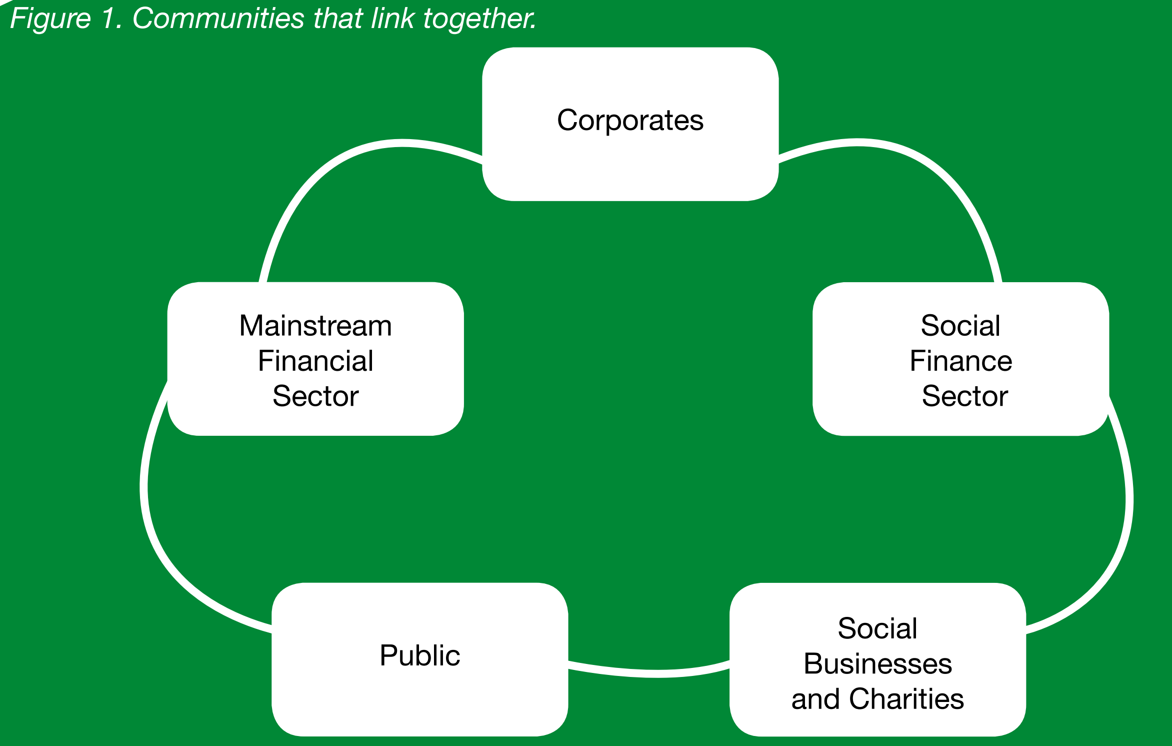
This section explores the recommendations from those within the sector.



Building Relationships

In the social finance space, strong relationships with stakeholders both inside and outside the sector are key. Developing these connections could attract welcome funding to an undercapitalised sector; for instance, Social Finance Ltd found that if just 5 per cent of retail investments in UK ISAs, 0.5 per cent of institutionally managed assets and 5 per cent of charity investment assets were attracted to social investment, this would unlock more than £10bn of new finance for social projects. This figure would be in addition to the £11.2bn that the social sector receives in non-government grants and donations each year. When it comes to collaborating with similar stakeholders, a number of organisations within the sector favour cooperation over competition. In order to share market expertise

Figure 1. Communities that link together.



and to develop a strategic partnership, Geoff Burnand says that at Investing for Good his team has developed a memorandum of understanding with fund managers The Social Investment Business in order to grow both of the firms.

"I think that there is a fair amount of duplication in terms of energies, so I think the more collaboration the better," Burnand says.

"As the sector gets better grounded, and as the business models get better established then I think there will be more competition as well. For us, there is a strong logic."

In terms of external relations, Allia's Tim Jones emphasises that the relationship between social finance and mainstream financial services is critical and needs to be developed. He says that for social finance to attract capital, more must be done to translate the language used by the sector into a lingo that "people who have money will understand". And with research by Nesta and Worthstone showing that 77 per cent of those that are likely to make social or ethical investments having no investments of this type,[V] Jones is among the commentators arguing that it is the sector's responsibility to improve communication with IFAs so they are able to advise their clients accordingly.

However, there is still a vast amount of headway that needs to be made before the merits of social finance are properly understood by corporates, says The Giving Department's Steve Wickham.

A global view

In terms of a global outlook, commentators feel that the sector should be more active in looking to create synergies with organisations overseas. As former Charity Bank chief executive Malcolm Hayday says: "This is not just a UK phenomenon".

In the US, Secretary of State Hillary Clinton recently hosted the 2012 Global Impact Economy Forum and in his 2012 budget, President Barack Obama announced that up to £62m ($100m) would be made available for pilot runs of Pay for Success Bonds, which would reward investors if projects achieve certain agreed social results.

In South Africa, a new social bank and online investment platform are being developed, while in Australia, the Federal Government has published a social investment strategy with The New South Wales State Government, procuring social benefit bonds for children in care.

Closer to home, the Euclid Taskforce was launched in late 2011 in the EU. Backed by the European Federation for Ethical and Alternative Banks and coordinated by Karl Richter, the taskforce was developed to establish a European Social Investment Facility by December 2012 in response to EU Internal Market Commissioner Michel Barnier's call for a European Social Bank.

Elsewhere, the European Investment Bank has backed a European Investment Fund which is now seeking another £40m (€50m) of private funding for a new European Social Entrepreneurship Fund, while the European Regional Development Fund and the European Social Fund recently invested €550bn in impact businesses.

And with the EIF recently investing in a Bridges Ventures fund, Geoff Burnand says there is potential to capitalise on these relationships in terms of attracting investment in the UK from abroad.

Burnand says: "Some of the products we are developing are easily passportable to other jurisdictions."

Though he recognises that interacting with charities can have a "significant impact on all sorts of facets of your business", Wickham believes that businesses often need help to wrestle with the reasons as to why they should invest in social finance. Only then will they be in a position to "commit the research and thinking to give them the 'how' and the 'what'", he claims.

Wickham believes that the responsibility for the lack of communication in this area lies with those with the greatest interest in the conversation being circulated: intermediaries, charities as the recipients of funds and foundations whose trustees are open to new and innovative ways of investing.

There also needs to be more dialogue with the media to help people recognise the sector as an emerging asset class, in order to "give the discussion teeth", adds Finance Lab fellow Karl Richter.

He believes that to truly raise awareness of the sector, social finance needs to be embraced by the mainstream media so that "people start to open up The Wall Street Journal or The Financial Times [and see] that there is a regular report on it".

In order to increase demand in areas such as social banking, Peter Mitchell, chief executive of CAF Bank, argues that better financial education could ultimately prove to be the "game changer" if it is able to successfully inform the mainstream public how their money could be used if directed towards social investments.

"For me, it all stems back to the education, because the education leads to understanding and the understanding brings the awareness and the willingness to use those tools," Mitchell says.

Fair Finance's Faisel Rahman points to the fact that social finance often positions itself as a distinctive sector, which can dissuade mainstream investors from entering the space.

Rahman thinks there are more practical steps to be taken to highlight similarities between the social finance sector and general investments, as he believes that demonstrating this likeness is the best way to ultimately harness institutional capital.

Rahman says: "Not enough social finance has been able to point out how similar it is to the rest of mainstream finance. There is a lot more money sitting in ISAs, pension funds and retail banks than there are angel investors sitting in the social finance space and people haven't quite got their head around that.

"They keep accentuating their differences and uniqueness, rather than saying it is similar and sustainable."

"Not enough social finance has been able to point out how similar it is to the rest of mainstream finance."

Rahman cites microfinance as an example of a niche sector that he believes has been better at stressing its similarities to institutional investment. Highlighting this resemblance has made it "much easier" for pension funds and banks to understand the data and metrics arising from microfinance entities and ultimately to "plug in" investments to their existing risk models.

"That has unlocked billions for microfinance around the world and I don't think anyone has understood how to do that in the social finance space yet. It is still too unique rather than similar," he says.

Standardisation

A crucial part of the development of the sector is the creation of standardised products across the social finance sphere. As with many areas of finance, simple and easily accessible services "make good sense," says Steve Wickham of The Giving Department.

"If factors relating to CSR and to social investment make good practical sense, they are far more likely to be adopted, and far more likely to succeed," Wickham says.

Products that are "beguilingly complicated" with huge costs to the business or consumer are "far less likely to succeed", he adds.

> "I think that in the consolidation process you lose the identity of the impact."

Karl Richter explains that to develop both supply and demand, the social finance market needs independent and aggregated investment data to "enumerate the market as a whole and by segments". He explains that for social investing to be taken seriously by institutional investors, there needs to be "elevated visibility of the financial data" so that investors can quantify real risks and weigh them against clear sector benchmarks.

Richter says: "For example, what pension funds want to know is: 'What are the financial returns? Is there a steady or lumpy yield? How does social investment perform compared with other investment choices? What are the write-off rates? What types of capital are deployed – equity, debt, or hybrids like mezzanine finance or quasi equity?'"

In a concept first mooted in TheCityUK's 2011 report 'Making Good In Social Impact Investment'[vi], Richter and his co-author Rupert Evenett are now developing EngagedX, an index that will aggregate and anonymise the financial data of social investments and show the various financial characteristics of investments in social organisations.

Richter explains that EngagedX will scale globally after the conclusion of the pilot phase, enabling investors to compare social investment to other asset types. He says that increased access to data will help to encourage mainstream financial institutions into this space, much as "indices drove the development of other capital markets such as junk bonds, which shook their derisory moniker and are now known as the 'high-yield' bond market".

But Social Finance Ltd's David Hutchison thinks that an index might have a negative impact on investor appetite.

He says: "The problem with an index is that you have to take your apples and oranges and pears and put them in a blender and end up with the same soup and I'm not sure that at the end of the day, the person who wanted to buy an apple will find the soup attractive, and won't see the identity of the apple. I think that in the consolidation process you lose the identity of the impact."

Direct Investment

One of the quickest ways to boost growth within the social finance sector is for intermediaries to use their funds to invest directly in social ventures, says Faisel Rahman of Fair Finance.

"Very little of the funding is around scaling new business opportunities," he says. "Intermediaries should be doing the innovative angel investing side of the work and looking at their job as leveraging a lot more."

Rahman argues that existing intermediary funds that are non-mandated and not limited by capital requirements should be used to build social businesses, which will enable them to go to institutional investors directly.

"The problem with a small number of investors is that there is never enough money. So you end up with undercapitalised businesses where you've got this unvirtuous circle of under-investment," he adds.

Rahman also highlights that foundations could be more proactive in funding social businesses by using their endowments to invest. He argues that the biggest opportunity for impact is in the funding of social organisations at a grassroots level, by allowing firms that are dealing with specific problems to be able to grow and tackle these issues on a larger scale.

He also advocates attracting angel investors as he argues that they look at risk in a totally different way, sometimes redesigning their risk models and methodology to accommodate businesses that do not have clear data sets.

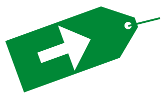
Rahman says: "Most of the institutional investors look at our clients and determine their risk return based on the clients rather than the model. The angel investors look at the model and then determine what their risk return should be based on that."

Secondary Markets

Allia's Tim Jones says that to move towards the mainstream, the social finance sector needs to develop a marketplace that is simple, liquid, and quoted, which must enable investors to know both the price of their asset and how they might realise this value.

To be launched in late 2012 and authorised by the Financial Services Authority, the Social Stock Exchange will enable the trading of securities in social purpose businesses. With investment of £850,000 from Big Society Capital, the exchange aims to open with around 15 businesses and grow over five years to offer shares from upwards of 200 companies.

The exchange will join the Bolsa de Valores Sociais of Brazil and NeXii, which runs in partnership with the Stock Exchange of Mauritius, as the world's first platforms to focus solely on social investments.



Moving forwards with retail

Retail investors currently invest small amounts of money into a small number of Financial Services Authority regulated social banks. But would an increase to the size of the retail market have the potential to act as a catalyst for the entire sector? For Tim Jones of Allia, attracting a greater amount of retail investment to the sector is "the absolute key" to getting the concept of social finance to work.

Jones believes there is potential to create social Individual Saving Accounts and Self-Invested Personal Pension products. He points out that there is currently £650bn invested in such products and urges the sector to create products that appeal to these investors in particular.

Progressing into these areas could also have a restorative effect on the mainstream retail banking sector, working in line with the government's proposition of social finance cities. Graham Allen MP says that an early intervention ISA launched in people's local areas could galvanise the populations of towns and cities into investing.

Allen says: "People would be civic minded and patriotic about their city and you could use it to really popularise this. I think there is a lot of branding and marketing potential out there."

But Finance Lab fellow Karl Richter says that due to a narrow band of permitted investments under the current regulatory structure, mainstream banks

Subsidies

Due to cost and time pressures, grant giving from foundations or targeted promotions can also be important in nurturing start-up social entrepreneurs and their ventures before they look to take on investment. Stephen Lloyd of BWB likens this need for subsidies to the SME landscape.

Referencing the government's recognition of the expense and difficulty in developing businesses, and its assistance in the form of tax relief and other incentives, Lloyd says that in funding a whole new set of socially-orientated businesses, social finance most certainly needs to be subsidised.

While Big Society Capital is prepared to provide investment, a number of social organisations need subsidies first to get to the position where they are investment ready.

"Far from distorting the market, the two things can work hand in hand," Lloyd says.

Microfinance is an example of where this worked, according to Paul Martin, senior corporate manager of charities at the Co-operative Bank. The microfinance sector was kick-started by social capital before it became a concept that banks were willing to invest in, "but banks are now happy, given the right circumstances, to invest in microfinance organisations" says Martin.

Lloyd agrees: "Once they'd proved the concept and demonstrated the returns, the capital started to flow."

Another example relates to the success of UK government subsidies for renewable energy, notes Joe Ludlow of Nesta. The feed-in tariff, where individuals and businesses are paid for creating their own 'green electricity', is an illustration of how revenue has been subsidised so that "businesses are more profitable and investors can get a better return on their capital," says Ludlow.

will only be able to develop such offerings if the market is segmented in order to match investment propositions with individual investment aspirations.

And Bruce Davis of Abundance calls for a careful strategy to be enacted due to the probable reluctance of individual investors to take a reduction in their financial return in exchange for social return.

Discussing the potential for banks to offer social products, Davis says the challenge is to define whether they are offering products to the retail investor or to the higher net worth individual who could be more willing to sacrifice a financial return if the project is able to achieve a social good.

Other commentators are similarly cautious about relying on social banking. Fair Finance's Faisel Rahman argues that consumer pressure will not lead to the development of products. Instead, he advocates disintermediation as a stronger solution.

"One side of this is to say 'can we do this through ISAs and banking systems' and the other is to disintermediate the whole relationship," he says.

Disintermediation also offers other benefits such as transparency. Bringing together a number of small investors would ensure that none have the power to set the firm's agenda, with this responsibility instead resting on the company itself.

"That puts a responsibility on the business to exercise a very clear and transparent strategy," says Jamie Hartzell of Ethex.

He believes that a market driven by individual investors will ultimately be a stronger and more sustainable system than one that relies on institutions.

> "The Ethex approach is to get lots of small investors so that none of the investors can really set the agenda. That puts a responsibility on the business to exercise a very clear and transparent agenda to know what it is doing."

But BWB's Stephen Lloyd thinks that the sector may accommodate different retail options, with disintermediation taking centre stage while mainstream providers catch up.

He thinks that the sector is starting to see "some frustration" about the lack of distribution by institutions, suggesting that in the near term peer-to-peer lending and crowd-funding are likely to take precedent until regulators clarify the rules that are currently preventing institutional investors and wealth managers from distributing these products.

Social Economy

With charities currently holding over £95bn in income and endowment funds[vii], the question arises as to why social enterprises and charities are not investing in their own sector.

"Every other sector invests in itself," says Esmée Fairbairn's Danyal Satter.

"In the social enterprise and charity space, three quarters of a million people are employed. The one sector their pensions and savings don't invest in is the sector they are working in, which is a bit crazy."

The most pertinent benefit social investment can offer charities would be the option to invest in line with their own missions, according to Abundance's Bruce Davis.

"Most large charities have big pension funds. If you examine exactly where that money goes, it is quite often at odds with the thing they stand for," he notes.

While charitable investment has increased by 13 per cent[viii], Karl Richter argues that in order to encourage a greater shift in investment behaviour from standard investments to social finance, increased visibility of investment profiles is needed. He says that each charity needs to be able to explore opportunities that are consistent with its own investment criteria.

Richter also argues that that instead of legislation, the market should be shaped so that charities can be asked why they are not choosing social investments that perform in the same way as their usual choices.

Efforts are underway on this, with the Charity Commission recently taking steps to alter guidelines on best practice encouraging trusts and foundations to look at mixed motive investments, according to Alisa Helbitz, head of research and communications at Social Finance Ltd. However, she acknowledges that greater clarity in this area would be welcome; a move that was called for in Conservative Peer Lord Hodgson 2012 review of the Charities Act 2006, entitled 'Giving Charity back to Charities'.[ix]

However, there is some uncertainty around the concept. FSG Consulting's Mark Kramer notes a "subtle tension" between adhering to a firm's social mission and in creating profitable investment opportunities for people.

"You can absolutely do both, but there is a line at which it is challenging to be faithful to both objectives at the same time," says Kramer.

> "Most large charities have big pension funds. If you examine exactly where that money goes in, it is often quite at odds with the thing they stand for."

But Tom Rippin of On Purpose argues that a charity's interest in social finance depends on its size. He says that while the large endowments of charities could be used more imaginatively, the majority of social enterprises and charities do not have the level of assets or the expertise to be making investments.

Meanwhile, other commentators are split as to whether there is a charitable appetite for social investment that is not linked to high returns. CAF Bank's Peter Mitchell says: "Charities want yield, yield, yield and some security with it as well".

Instead, he proposes that charities and social enterprises can reinvest in the sector by using a charitable bank. Under this system, "the value that would otherwise be paid away to one of the major high street banks is retained," Mitchell says.

Talent

Alongside transparent data and the ability to offer social and financial returns, talented staff are often a critical ingredient in ensuring that social ventures can scale up. Indeed, the lead entrepreneur's attitude and time are the "key resource" of the enterprise, says UnLtd's Jo Hill.

"We think it is people who really make the difference, people who drive change, so we have a very particular focus on supporting, finding and sourcing those individual leaders," says Hill.

Peter Mitchell of CAF Bank highlights that talent is paramount to the culture shift that is needed in the sector. He argues the answer is "not teaching organisations to use finance effectively", but having knowledgeable and passionate people moving into positions of authority.

FSG Consulting's Mark Kramer explains that the type of person the sector needs is a generalist with skills cutting across a number of areas. "There are people who have technical expertise, there are people who have social sector expertise and there are people that have financial expertise, but there aren't a lot of people who have all three," he says.

Hill says that in her experience, insiders who have worked in an industry for a decade or two and have spotted an opportunity are the most successful.

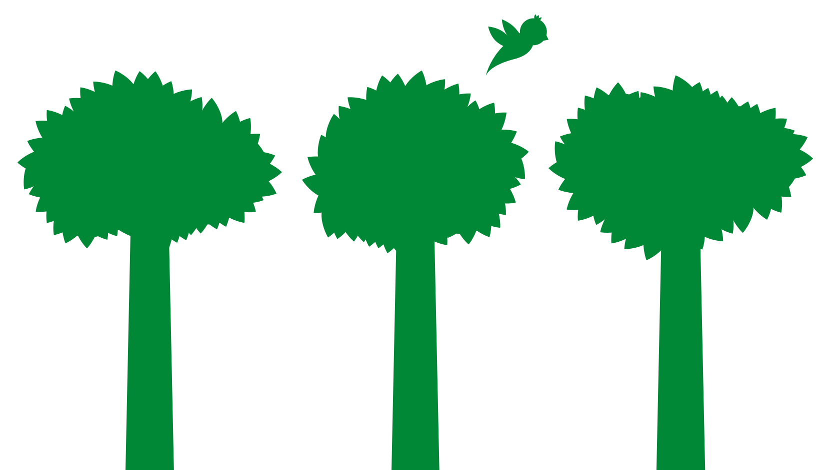
She says: "Those entrepreneurs who come at the problem having experienced it themselves have a harder time making the business model work, because they haven't started with the market in mind, they've started with the product in mind."

Hill adds that universities could be doing more to educate people about the opportunities presented by the social finance sector. While universities in Northampton and Portsmouth have recently set up social enterprise hubs, Hill calls for specific programmes for students.

"I'd love to see more social entrepreneurship programmes in universities but with a real focus on market testing," she says.

But Tom Rippin of On Purpose feels that while student demand drives the inclusion of masters programmes and MBA modules, ultimately what is needed is a clear, defined and prestigious route from education into a social enterprise career. He says it is crucial that individuals start at a relatively early stage in order to gain significant experience in the sector.

Rippin says: "In no other sector would we assume that someone who had worked in a completely different sector for the last 20 years can just transition in and become a chief executive."



Looking Forward

In line with the emergence of serious complex global problems, and amid questions about the nature and purpose of investment, social finance can be seen as a contributor towards a significant reframing of capital markets. But will it reside in a field of its own, or will it manage to change the behaviour and organisation of economics forever?

In the view of some commentators, social finance can have a significant impact on the way firms invest. Eventually, all money will be assessed not only for its financial value, but its social impact too, in the opinion of Geoff Burnand from Investing for Good. Similarly, Ethex's Jamie Hartzell says that every business has to become a "triple bottom line" business, incorporating equity, environment and economics, meaning that social investment will become the only form of investment available, in his view.

Luke Fletcher of BWB explains that when the state, the private sector and the civil society cease to be segmented, a social economy will develop and the aim of finance as it currently stands will change.

Fletcher says: "Within that particular ecology, profit is not an end in itself, it is a means to an end. The real question is, why are you trying to generate a surplus? What is the impact that you are trying to create with it?"

To ensure businesses are socially orientated, widespread cultural changes would have to happen "at the regulatory side, at the corporate side, and at the society side", according to Bertrand Beghin of Numbers4Good. However, he is quick to emphasise that this is ultimately not the role of finance. Instead, business should "pick up on the social business trend and then deliver [the results]", he says, arguing leadership is needed from government, think tanks and academics.

But according to Faisel Rahman of Fair Finance, the challenge is not "how do we get business to be more social?" because those listed in the market have very clear expectations of what they need to produce. Instead, he believes there should be more of a focus on partnerships.

"You would never expect a mainstream bank to do what Fair Finance is doing, but we could expect a partnership between the two. Once that is done, there could be a lot of social finance raised in order to do that."

However, social finance might need to operate as a different financial market for reasons of profitability, notes Nesta's Joe Ludlow.

Ludlow says: "On the revenue side, people aren't prepared to pay for real costs of those social ventures doing business. They are less profitable organisations so they need less expensive capital."

Timescales

With debates still raging about the pitfalls of capitalism and whether inherent changes may be needed for the future, MP Harriet Baldwin believes the time may have come for social finance to be galvanised into action. She notes an "untapped appetite" among investors to put their money to use in an area where both financial and social results can be achieved.

Bruce Davis of Abundance agrees that the market has reached a tipping point in practical terms too.

He says: "It has come of age. Up until now, it has been a philanthropic mode of using your money."

But despite this progress, commentators are split about the length of time it will take for the sector to develop in its own right, which some argue is crucial before social finance is able to have an impact on the investment practices of mainstream financial services. A number of observers call for this to be sped up, with Esmée Fairbairn's Danyal Sattar urging for an expansion over the next two to three years.

"We should see some shifts, then there will probably be another phase of people saying 'oh there is something here, we will develop more products'. Bigger players will then come to it and then maybe we'll scale a bit more in years four, five and six," Sattar says.

In terms of sector development, UnLtd's Jo Hill thinks that the rapid development over the past 12 months will continue and there will be "a different infrastructure in five years". Harriet Baldwin MP believes that due to the advent of Big Society Capital, enormous strides will be taken in the next four years.

However, Alastair Davis of Social Investment Scotland believes development of the sector will be a more lengthy process. He notes it has taken SIS 10 years to get the charitable sector used to the idea of taking on loans.

"You could be looking at the same time again, at least I would say," says Davis.

He argues that acceleration may now be quicker with the spotlight now focused on the sector, but that this "relies on organisations moving with ambition". Allia's Tim Jones is however more optimistic, arguing that the timeline to a market which is identifiable and consolidated could be less than two years.

Jones adds: "The danger is, if we don't get on with it, there will be another political system with different priorities and we will all be shuffling about again.

"So it is vital that we crack on."

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Appendix A - Interviewees

All quotes in this report are derived from interviews between the author and the contributors below.

Alastair Davis, Chief Executive, Social Investment Scotland

Alisa Helbitz, Director of Research and Communications, Social Finance Ltd

Bertrand Beghin, Founder and Director, Numbers4Good

Bruce Davis, Co-founder and Retail Director, Abundance

Danyal Sattar, Finance Fund Manager, Esmee Fairbairn

David Hutchison, CEO, Social Finance Ltd

Faisel Rahman, Founder and Managing Director, Fair Finance

Geoff Burnand, Co-founder and CEO, Investing for Good

Graham Allen, Member of Parliament for Nottingham North

Harriett Baldwin, Member of Parliament for West Worcestershire and Vice-Chair, The Social Investment Business

Jamie Hartzell, Managing Director, Ethex

Jo Hill, Interim Director of Ventures, UnLtd

Joe Ludlow, Impact Investment Director, NESTA

Karl Richter, Fellow, The Finance Innovation Lab

Kevin Williams, Chief Executive, KIDS

Luke Fletcher, Associate, BWB LLP

Malcolm Hayday, former CEO, Charity Bank

Mark Kramer, Founder and Managing Director, FSG Consulting

Mark Sesnan, Managing Director, Greenwich Leisure Limited

Martin Sime, Chief Executive, Scottish Council of Voluntary Organisations

Paul Martin, Senior Corporate Manager of Charities, Co-operative Financial Services

Peter Mitchell, CEO CAF Bank

Rob Parker, Social Investment and Finance Team, Cabinet Office

Stephen Lloyd, Senior Partner, BWB LLP

Steve Wickham, Director, The Giving Department

Tiina Lee, Head of UK Strategy, Deutsche Bank

Tim Jones, Chief Executive, Allia

Tom Rippin, Founder and CEO, On Purpose

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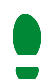

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