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THE LANDSCAPE OF SOCIAL INVESTMENT:

A HOLISTIC TOPOLOGY OF OPPORTUNITIES
AND CHALLENGES

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WITH CATHY PHAROAH

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ABSTRACT

This report provides a holistic account of the state of play in the emerging field of social investment, defined as the flow of resources – either market or non-market generated – that fulfils the funding needs of organisations that primarily create social or environmental value. It also looks forward to some of the future opportunities in this space. The main conclusion is that the development of social investment is currently at a crossroads: there is enormous potential for growth, but there are also formidable institutional barriers to be overcome. This research assesses both current research and practice across institutions in supply, intermediation and demand in order to analyse current developments and build proposals for taking advantage of future opportunities. It sets out key definitions and builds a series of analytic frameworks and applies them to the landscape of social investment. Although highly innovative, social investment institutions are still marked by traditional boundaries which

actors from the private, public and third sectors find it difficult to cross. Issues of risk are seen as the main barriers, but it is suggested that discussion of risk masks deeper uncertainties about the role and value of social return. Such uncertainties are reflected in ambiguities about the extent to which social investment is non-profit or for-profit in nature, in divergent views about the role of intermediaries, and in assessments of the value of the further development of social equity finance as a way of increasing the social investment market as a whole. This paper considers macro-structural questions that require a reassessment of some of the assumptions built into current frameworks for analysing the state of social investment, which are still heavily influenced by conventional capital market models. In addition, it outlines a number of opportunities for addressing micro-market issues that could support the further growth of social investment, particularly for social enterprises.

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A Holistic Topology of Opportunities
and Challenges*

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GLOSSARY

CDFI	Community Development Finance Institution
CITR	Community Investment Tax Relief
SROI	Social Return on Investment
SRI	Socially Responsible Investment
APO	Alternative Public Offering
SME	Small and Medium-Sized Enterprises
REDF	Roberts Enterprise Development Fund

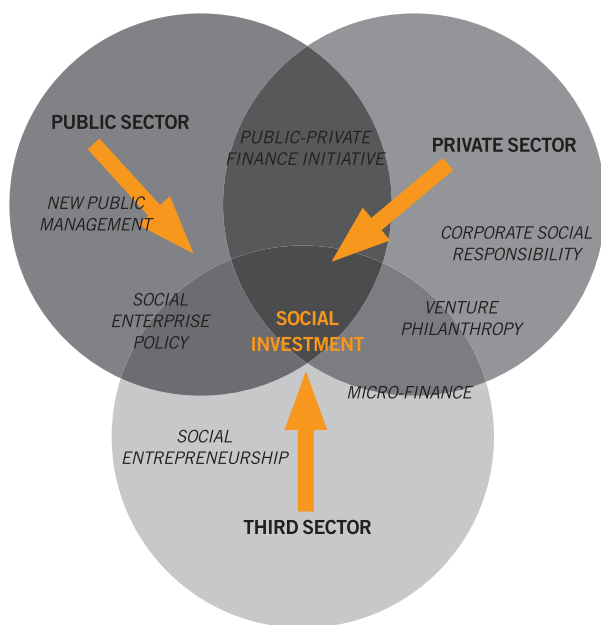
INTRODUCTION

The past twenty years have seen a dramatic change in the definitional boundaries set around the finance sector. As financial services have grown in size and influence in developed economies, the traditional boundaries between 'economic-' and 'social-' purpose activities have become increasingly blurred (see Offer, 2001). From a public policy perspective, private finance has been encouraged to play a much more active role in financing public goods and services, with new contractual models such as the Private Finance Initiative blending public and private finance at a project level (LeGrand and Bartlett, 1993; Bult-Spiering, Dewulf, 2006). Key opportunities for a new type of finance have included addressing economic exclusion and poverty (Yunus, 1998; HM Treasury, 1999; Reifner, 2000; Guene and Mayo, 2001), and supporting community regeneration (Leadbeater, 1997; Westall, 2002; HM Treasury, 2002; Gardiner, 2006). More recently, governments have also been exploring how better to support outsourcing relationships that go beyond the private sector to include charities and other public benefit organisations (Salamon and Anheier, 1999; Giddens, 2000; DTI, 2003; HM Treasury, 2007;). In the UK, the establishment of a Social Enterprise Unit within government aimed to create an enabling environment for the growth of social enterprises across the country, many of which engage with service provision (DTI, 2002; OTS, 2006).

From an investor perspective there has been a growing recognition of the connection between the allocation of finance and its human and environmental impacts, leading to a demand for a new set of investment opportunities loosely (and sometimes misleadingly) classed as Socially Responsible Investment (SRI). In 2005, the SRI market in the USA amounted to £1.4 trillion (Social Investment Forum, 2006). From a corporate perspective the use of finance is under increasing external scrutiny from consumers and engaged shareholders driving new organisational strategies often described as corporate social responsibility.

Finally, from the perspective of organisations in the third sector (those that are chiefly engaged in creating public, social or environmental value, rather than private value), there has also been a dramatic change in resource strategies. Driven by a new wave of innovation and social entrepreneurship, strategies are being developed to support start-ups, growth and increases in organisational scale (Nicholls, 2004, 2005, 2006a, 2006b). All of these changes in perspective have contributed to a wide range of debates around an emerging hybrid form of resource that this report will call social investment (see Figure 1 and below for a full definition). We will focus on the role of social investment across a spectrum of social purpose organisational models from those that generate 100% of their own earned income to those that are entirely reliant on grant funding or voluntary resources.

FIGURE 1: DRIVERS BEHIND SOCIAL INVESTMENT



This report functions as an analytic survey of the state of research and practice in social investment today. It has five specific objectives:

- To assess the current landscape of social investment research and practice
- To provide an analytical framework for current initiatives
- To identify strengths and weaknesses in the emerging models
- To assess needs for future research and development
- To identify key opportunities and challenges going forward

The report begins by setting out definitions before presenting a series of analytic frameworks that will be used to draw out the key challenges and opportunities in the future development of social investment. The main body of the report is then structured to reflect the shape of the social investment landscape itself, namely into demand-side, intermediary and supply-side clusters of initiatives and issues. The legal and policy context is also sketched in. The report then goes on to consider the implications of the current landscape in terms of key areas for future development. It concludes by drawing together the

analysis across each section to make a series of practical proposals.

Many of the organisations within this landscape demonstrate high levels of innovation and market-facing strategic approaches, whilst also maintaining a strong social purpose. This type of organisation is described here by the umbrella term ‘social entrepreneurship’.¹ Whilst there remains much debate about the boundaries of social entrepreneurship, this report supports the notion that it is present across all the conventionally conceived three sector of society and, perhaps particularly, at the dynamic and shifting interfaces between them. Consequently, public, private and third sector elements of the social investment landscape must all have a role in growing capital flows into projects that can achieve outstanding social and economic returns in the future.

Figure 1 (above) maps out the basic elements of social investment today as they occur across the three sectors. Social and ethical investment could be added to all three sectors. However, it should be noted that this is a normative – and simplified – world view and that important exceptions exist. For example, social investment has emerged without government (Venturesome), without the private sector (Futurebuilders), and even without the third sector (Bridges Community Ventures). Furthermore, government and the private sector have largely acted on the supply-side, whilst the third sector has typically been on the demand-side.

¹ Social entrepreneurship is defined here as any individual, organisational or network activity that demonstrates each of the following: sociality (ie a social or environmental mission as its prime strategic objective); innovation; market-orientation (ie a performance-driven, comparative and competitive, outward-looking approach to strategy and operations). Social entrepreneurship exists across the entire social investment spectrum, from the voluntary sector to social enterprises operating in commercial markets. It is also found in the public sector. See further, Nicholls and Cho (2006).

BACKGROUND

A number of important reports on the emerging social investment landscape have been published recently (see Table 1). Notable amongst these are works by Emerson and colleagues (Emerson, Freundlich and Fruchterman, 2007; Harold, Spitzer and Emerson, 2007; Spitzer, Emerson and Harold, 2007; Emerson and Spitzer, 2007), Nicholls (2007) and Hartzell (2007), as well as collaborative reports from the New Economics Foundation and Charities Aid Foundation (2006), Venturesome and Futurebuilders (Unwin, 2006), NCVO (2007), UNEP (2006), the Foundation Strategy Group (Cooch and Kramer, 2007), Triodos Bank (2006) and others. In addition there have been reports from UK public institutions (Bank of England, 2003), transnational bodies (Emerson, 2006), foundations, and sector-specific consultants within venture philanthropy (for example, see John, 2006, 2007, further below).

A survey of this work on the social investment landscape reveals a number of recurring themes that can be grouped under two headings: macro-structural level and micro-market level. Macro-structural issues focus on the barriers to developing a more coherent account of what social investment is and how it can operate. Emergent themes related to different types of market failure include:

- Conventional notions of the role of finance and financial markets are increasingly inappropriate for a discussion of social investment
- Few metrics exist to account for social and environmental externalities (whether positive or negative)
- Concepts of social investment are blurring the boundaries between private, public and third sector investment
- Social investment players operate in a fragmented landscape with little exchange of information or incentives for co-operation (Emerson and Spitzer, 2007)
- There are considerable information asymmetries and coordination problems across the landscape
- There is a lack of financial literacy in social purpose organisations that supports a risk-averse approach to new resource strategies (Bank of England, 2003)
- Regulation and legislation are lagging behind trends in social and environmental investment (Harold, Spitzer and Emerson, 2007)

- There are limits to the current absorptive capacity of the demandside

- There are gaps in the supplyside offerings

Micro-market analyses, on the other hand, focus on exploring specific allocative/exchange mechanisms by type of finance. The bulk of such work has considered how best to develop a social investment exchange or stock market.² Emergent themes include:

- Conventional finance markets do not price social or environmental value creation and, consequently, cannot be used to allocate resources to non-profit-maximising organisations effectively (Harold, Spitzer and Emerson, 2007)

- There is a lack of comparable performance information (metrics) to support the creation of a new or modified social investment marketplace (Nicholls, 2008)

- There is a lack of liquidity to support the creation of a new or modified social investment marketplace

- There is little evidence of strategic segmentation of the investor pool for social investment

- Conventional finance instruments are underdeveloped or inappropriate for social investment exchanges

- There is a lack of appropriate capital engaging with social investment (Nicholls, 2007)

This report contributes to this important body of work in two ways. First, it approaches social investment from a holistic perspective, considering the relationship between supply and demand as its central analytic unit. Second, it engages with the full range of social investment instruments and investment options, rather than focusing on one particular section of the landscape. As a result, this work attempts to provide a synthesis of existing research in an analytic framework to help drive debate and praxis forward.

It is intended that the audience for this report will include academics, policy makers, social entrepreneurs, other third sector organisations, socially motivated investors and finance professionals interested in new 'social' investment opportunities offering full or partial market return, as well as philanthropists and foundations.

² There are several references in the literature to the social capital market (Emerson, 2003; Kavanagh, 2000; Meehan, Kilmer and O'Flanagan, 2004; Young, 2006; Hartzell, 2007). This does not refer to the more common notion of 'social capital' developed by Bourdieu (1986) and later popularised by Putnam (2000). Social capital in Putnam's sense refers to the social networks that are an integral part of social groupings and has been utilised in research and policy as an indicator of the strength of social and community relationships. Emerson, Freundlich and Fruchterman (2007) make an interesting distinction between 'integrative' and 'transactional' social capital, with the former representing Putnam's definition and the latter referring largely to social investment. Emerson Freundlich and Fruchterman (2007) note, however, that the two are linked as part of an 'integrated social capital market of which all human exchange (whether social or financial) is part' (p6).

TABLE 1: RECENT REPORTS ON SOCIAL INVESTMENT

REPORT	TARGET INVESTOR	INVESTMENT MODEL	LEVEL OF ANALYSIS
UNEP (2006)	High net worth individual	Full market return to blended return	Micro-market
Cooch and Kramer (2006)	Foundation	Mission-related investment: blended return	Micro-market
Griffith (2006)	Foundation Other grant maker	Mission-related investment: blended return	Micro-market
Emerson (2006)	Non-specific	Finance market	Micro-market
Unwin (2006)	Non-specific	Match market	Micro-market
New Economics Foundation/ Charities Aid Foundation (2006)	Non-specific	Finance market	Micro-market
Emerson, Freundlich and Fruchterman (2007)	Venture capitalist/Venture philanthropist	Risk finance	Micro-market
Commission on Unclaimed Assets (2006)	Unclaimed assets	Mission-related investment: underwriting and guarantees	Macro-market
Triodos (2006)	Non-specific	N/A	Macro-structural
Emerson and Spitzer (2007)	Non-specific	Finance market	Macro-structural
Nicholls (2007)	Government	Ethical market	Macro-structural
Spitzer, Emerson and Harold (2007)	Environmental	Finance market	Micro-market
Harold, Spitzer and Emerson (2007)	Real estate	Finance market	Micro-market
Hartzell (2007)	Non-specific	Finance market	Micro-market

SOCIAL INVESTMENT DEFINED

Social investment can be pictured, very broadly, as the resources required to empower social and environmental change. These include: financial capital (money), social capital (networks) and human capital (expertise and skills). In this report, however, social investment refers only to finance supply and distribution to support social purpose organisations that address, as their first strategic objective, public and environmental challenges. Social investment, therefore, is about more than just the flow of money into social or environmental projects. It is an ethos about the way money is used, as in, for example, the mission of the International Association of Investors in the Social Economy, to demonstrate to the world that money can actually be a means to achieve positive social and environmental change (INAISE, 2007). So, social investment can be seen as the discourse around such flows that is developing in concrete terms in the new institutions of supply, intermediation and demand.

When considering social investment, it will be important to bear in mind the power relationships inherent in any transactional situation. Such relationships generate several different perspectives on social investment depending on the actors' transactional position and power. It will be important to clarify the specific objectives of social investment case by case, determine the relevant theory of change, and establish who controls the investment agenda at any given time. For example, three very different perspectives on an investment in an

education project could see it variously as spending (public sector), speculating (private sector) or asset building (a school).³

These differences, in turn, are the product of actors' motivations for engaging in such transactions and it is likely that these motivations may, at times, be in conflict. Of course, this is also the case in the transactions of conventional finance and is largely addressed by the conventions of contract law. One important thing to note at the outset is that, as yet, there is no distinct contract law for social purpose organisations.

The social investment discourse is also in flux, with competing perspectives driving the debate. Yet the key actors in this debate represent a surprisingly small pool that is still struggling to broaden the range of interlocutors. These actors split into three main groups: finance professionals who have moved away from conventional banking towards social investment; third sector entrepreneurs; and government policy makers, consultants and commentators who have recognised the need for more creative approaches to the evergreen issue of generating greater resources for social and environmental projects.

At the moment the discourse around social investment is heavily influenced by the language of the private sector and the logic of capital markets. This, at least partly, reflects the influence of key players from conventional finance institutions who have started up new organisations in the social investment space over the past ten years (for example: New Philanthropy Capital; Generation

³ My thanks go to AliBeth Somers for these insights.

⁴ It is interesting to consider that what is routinely presented as one of the main contributions of venture philanthropy (its managerial engagement: John, 2007) could be recast as a serious infringement of third sector independence.

Investment Management; European Venture Philanthropy Association; London Bridge Capital). This has led to a number of initiatives that aim to frame social investment within the normative language of financial economics – in effect, to explore how social investment fits within standard business models and analytics. The dominant logic of this approach is that the market is currently failing to price in social and environmental value, with the result that social investment appears unattractive to mainstream investors. The solution appears to lie in repackaging social investment so that it better conforms to market expectations of an investment and, thus, reaches a broader pool of capital – essentially a restructuring of products.

A more radical take on this might suggest that capital markets can be transformed in the restructuring process to institutionalise new, enhanced, analytics that better recognise investment opportunities. This line of argument would suggest that the growth of interest in renewable energy companies, for example, might be the precursor of a sea change in valuing green and environmental strategies within all other firms (eg Harold, Spitzer and Emerson, 2007).

However, there is an alternative discourse that is slowly emerging. Here markets are not seen as conventional trading mechanisms that determine price, but as a means to discover value (eg Polanyi, 1944). In these marketplaces social investment challenges convention and can assert new normative values as well as recognise value. Such a discourse does not aim to fit social investment into conventional capital investment models but, instead, aims to build a new narrative around what resources (not only finance) can do to drive forward social and environmental change. Built around social capital and notions of community and connectivity, this vision of social investment draws upon Smith's Economics of Regard rather than the currently dominant neo-liberal "invisible hand" model (see Offer, 2006). The institutions of social finance in this line of evolution will not come with high-powered individuals from established financial houses, but rather from grassroots action, co-operatives and community groups consolidating and building out towards new investors. This has been the path that has taken microfinance into the mainstream, for example.

From the grassroots perspective, the most important issue is not access to finance, but where the power in such transactions lies. One of the

reasons why the demandside of social investment is, perhaps, underdeveloped (see below) is that much of the finance on offer has – or is perceived to have – the intention of influencing organisational strategy.⁴ In the worst cases this could cause serious mission drift. If this type of social finance is to move away from grants and self-funding and farther towards capital markets, then new institutions will need to evolve that can mitigate the mission risk of taking capital investment from new sources.

At present, these two streams of social finance are operating largely apart. One of the challenges in the further development of social investment will be to broaden the debate around social finance to engage both ends of the spectrum. This wider debate should include practitioners and academics in public finance, welfare economics and the other social sciences, as well as public sector professionals, all of whom can contribute significant expertise in some of the key issues noted above (for example, how to value social goods and return on public investments: REDF, 2000).

Social investment is still a fluid idea. A signpost to the space it occupies is the new –sometimes uneasy – terminology being built from the cross-fertilisation of social and finance/economic concepts, such as philanthrocapitalism (Makower, 2006); natural capitalism; social capital; social venture capital; venture philanthropy (*The Economist*, 2004); blended value returns (Emerson, 2003, 2006); social return on investment (Emerson, 1999; Nicholls, 2004); social enterprise (Alter, 2006) and so on. Today, 'social investment' acts as an umbrella term covering a number of distinct but related developments in resource strategies for social and environmental projects and organisations.

Different categories or sectors within social investment can be distinguished by identifying the key characteristics that place them within the overall field. For example, one typology might locate and compare them within dimensions such as:

- Purpose of social investment (development, market return, infrastructure)
- Type of investment (grant, debt, equity)

Table 2, below, provides a preliminary identification of some of the main activities that can be considered as part of social investment, revealing different orientations to the dimensions outlined above. These

TABLE 2: CATEGORIES OF SOCIAL INVESTMENT

PURPOSE OF SOCIAL INVESTMENT	TYPE OF INVESTMENT	EXAMPLE
Investment in surplus-generating businesses with primarily social or environmental purposes at a return, possibly lower than market rates	Grant Debt Equity	Cafédirect
Investment in businesses which are primarily profit-making but which also have a clear social or environmental purpose	Debt Equity	Baywind
Investment in commercial opportunities in deprived areas	Debt Equity	Bridges Community Ventures
Investment in “social firms” that employ disenfranchised members of the community	Grant Debt Equity	Furniture Resource Centre
International provision of small-scale and low-cost banking services for poor individuals and communities	Debt	Microfinance
Acquisition and use of community assets to support social and economic community initiatives	Grant Debt	Community Development Finance Institution
Highly engaged philanthropic funding used as a form of “venture capital” for investment in innovative and sustainable social projects	Grant	Venture philanthropy
Use of government and other funds to create an accessible intermediary social investment structure	Grant	Commission on Unclaimed Assets

categories are not mutually exclusive – finance generated in one category is often used to support growth in another.

Overall the scale of the social investment movement is expanding. Wood and Martin (2006) commented on *clear signs of a shift in the allocation of social investment*, referring as evidence to the growth of the third sector globally, the expansion of service delivery contracts, the growth of microfinance and its move into secondary markets, and the emergence of social entrepreneurship. Within this broad trend, however, there is lumpy and uneven growth. Some categories are beginning to develop their own finance sub-markets with their own characteristics – ethical and socially responsible investment, for example, is already part of the mainstream

finance market. Microfinance is developing its own market – commentators such as Baue (2005) believe that microfinance and the development of community property assets are already very close to representing new asset classes for commercial investors (Nicholls and Young, 2008).

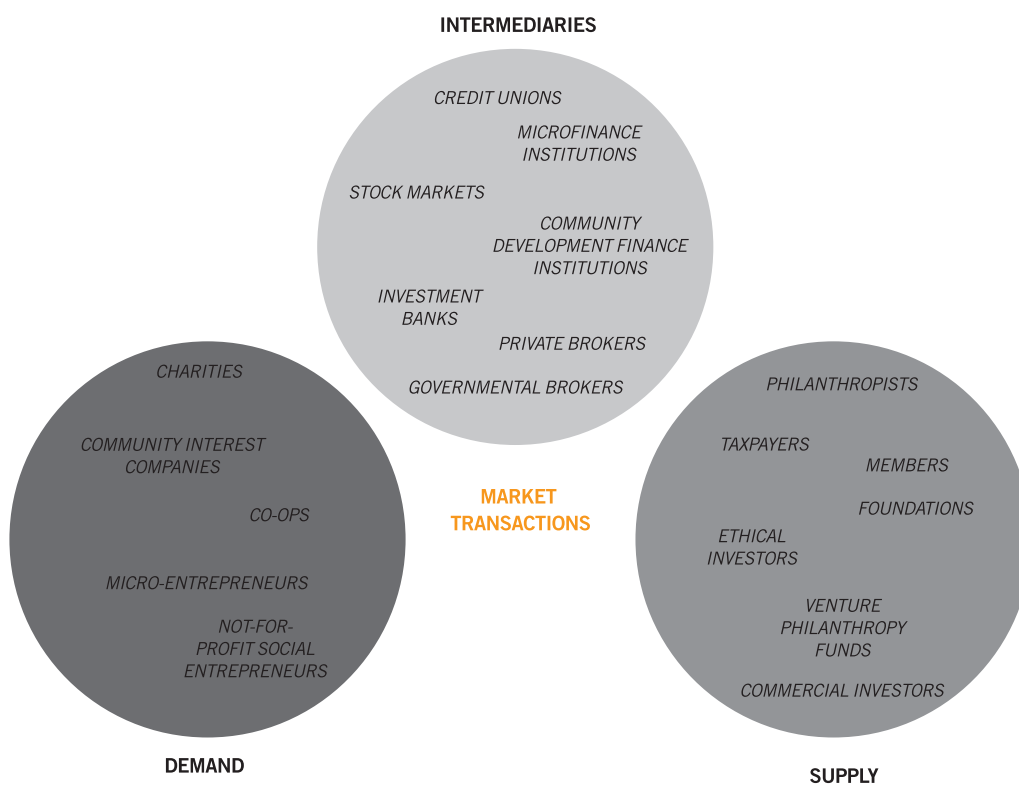
Clearly the development of microfinance responded to a huge market need amongst poorer communities in the developing world with no access to affordable small-scale finance (Yunus, 1998). Credit unions have grown fast to fill some of the market gap amongst financially excluded communities in western Europe, although only a few have reached a significant scale. But other categories within social investment, such as social equity finance, risk capital and social market development finance, are growing much more slowly.

THE STRUCTURE OF THE SOCIAL INVESTMENT LANDSCAPE

As has already been noted, this report aims for a holistic account of social investment across all its constituent institutions. As a starting point for framing this discussion the key players in demand, intermediation and supply are set out within a rudimentary market framework (see Figure 2).

Key players within each part of the social investment landscape will be defined more precisely in the following sections on demand, intermediation and supply. Note that the multiple roles of some of these players mean they can be considered under different headings, so, for example, the government is clearly a key source of supply, but also has an intermediary function. One initial framing observation is that there would appear to be a significant mismatch between supply and demand, such that many social entrepreneurs are turning to self-financing strategies to start and grow. However, the real picture may be more complex, including the poor provision of effective intermediaries and a lack of investment-ready socially and environmentally innovative projects. These matters will be considered further below.

FIGURE 2: THE STRUCTURE OF THE SOCIAL INVESTMENT MARKET



DEMANDSIDE

INVESTEES

At this early point in the development curve of social investment it is difficult to assess the real level of demand or identify trends for its future shape. Current demand is largely supply-led. As has already been noted, key players on the demandside of the social investment landscape include social entrepreneurs.

There has been a lively debate over the past ten years concerning what Perrini (2006) notes are the special and general cases for the organisational forms of social entrepreneurship. Central to this debate is the issue of funding and, particularly, the nature of 'social enterprise'. Whilst social enterprise and social entrepreneurship are sometimes used as synonyms (particularly in the USA), the former is, in fact, a subset of the latter. The primary distinction lies in which funding model is adopted with respect to achieving a social objective, namely social enterprises look to move away from grant-dependency towards self-sufficiency via the creation of independent income streams. These are particularly attractive to more conventional investors seeking a financial return as well as a social one. However, we still know little about either the kinds of returns social investors may be looking for or desirable balances between financial and social returns.

Despite the ongoing discussions in the literature concerning the boundaries of social entrepreneurship and how it may best be defined (for a summary of conflicting definitions see Mair, Robinson and Hockerts, 2006, pp4-6 and Perrini, 2006, pp9-10), three key determining features can be discerned that differentiate social enterprises from other organisations: sociality, innovation and market orientation (Nicholls and Cho, 2006).

Sociality is defined as the extent to which an organisation intentionally and effectively pursues the advancement of objectives identifiably in the public interest, typically evidenced across three dimensions: the sectoral focus of the organisation (eg health, education, the environment); its processes and management strategy (ie employing disenfranchised workers, incorporating as a mutual or co-operative society); and its outcomes and impacts (increased social welfare, social inclusion, improved sustainability, economic development).

Innovation reflects established patterns of entrepreneurial action set out in conventional accounts of commercial start-up activity. In other words, socially entrepreneurial actors pursue systemic change via processes of bricolage and arbitrage across social goods.

Key characteristics are questioning approaches, creativity, relentlessness, opportunity recognition and risk-taking.

Market orientation is conceived here as not only an engagement with commercial 'markets' as a resource strategy (though this is central to the social enterprise model), but more generally as a self-reflexive and outward-looking strategic orientation that demands outstanding and constantly improving social change impacts and outcomes. Social entrepreneurs cast themselves in a range of competitive contexts – funding, innovation, quality – in order to maximise their utility to the beneficiaries. Thus, socially entrepreneurial organisations see themselves in a market for the provision of social or environmental goods that generates relentless change and social improvement. Social entrepreneurs relentlessly drive towards greater impact and innovation in their given fields.

The proportion of each of these three features found in a given example of social entrepreneurship differs over time and is contingent on exogenous cultural and sectoral factors. For example: an established socially entrepreneurial organisation in the service delivery field may well build new models on existing operational best practice (lower innovation) but demonstrate more sensitivity to its beneficiaries (higher sociality) and explore new resource strategies, including earned income (higher market orientation). On the other hand, a start-up socially entrepreneurial organisation driven by new technology may display high innovation but lower market orientation because it is dependent on traditional grant funding.

Initiatives such as the School for Social Entrepreneurs (SSE), BizzFizz and UnLtd aim at supporting individuals in the UK, and Echoing Green is a notable international example. Ashoka has been a pioneer in publishing evaluations of its work, and the SSE, which consists of six member schools, recently published an evaluation showing strong performance amongst organisations with SSE participants (New Economics Foundation, 2006).

Social entrepreneurship represents a spectrum of activity encompassing different loci of action (public as well as private), organisational forms (government departments, charities, community groups, co-operatives, private limited companies), and resource strategies (grants, donations,

membership fees, earned income). Figure 3 places socially entrepreneurial organisations along a spectrum according to their relationship with the market, from charities without trading income to 'social businesses' that make a commercial profit. Such a spectrum may suggest that there is a Pareto relationship between social value and financial value with non-market-facing organisations generating more social value. However, social entrepreneurship rejects the traditional view that 'value' can be understood as either economic or social and that these two notions are quite separate, with for-profit business generating the former and not-for-profits the latter. Rather social entrepreneurs recognise what has been termed *blended value* (Emerson, 2003, 2006) in which social and economic value creation are intrinsically linked within all action.

It is clear that different organisational forms of social entrepreneurship will need different sorts of finance and will appeal to different sorts of investor. This spectrum of resource needs is, therefore, a useful tool to help segment the investor marketplace (see below). The conventional distinctions used in analyses of funding within the third sector more generally are useful here. Weisbrod (1998), for example, identified three categories of funding, each of which has organisational implications:

- Commercial market activities financed by purchasers – outputs must be profitable
- Government contracts financed through taxation – outputs will be politically directed and may have zero cost for beneficiaries
- Grants and donations – outputs will be mission driven, sometimes by the donors

These distinctions provide a useful reminder that the landscape of social investment will always include non-market-based revenue streams and that, consequently, a reliance on market models to drive the supply of social investment forward will necessarily lead to an incomplete account of the extant range of opportunities and challenges.

In the UK social investment has been predominantly seen as a business investment tool, but the government's recent third sector report puts a renewed emphasis on the need to provide

further support for social enterprise leaders as a way of boosting the growth of social enterprise (HM Treasury, 2007). Furthermore, much policy has focused on the social enterprise part of the social entrepreneurship spectrum. It has been assumed that social enterprises will provide an attractive new social and economic investment opportunity, because they raise the prospect of some level of financial return as well as social value creation. The UK Department of Trade and Industry (DTI) defines this heterogeneous group of organisations in this way:

A social enterprise is a business with primarily social objectives whose surpluses are principally reinvested for that purpose (DTI, 2002).

As a result finance policy on social enterprise has been premised on the assumption that it can be best served by variations on existing financial institutions. However, it has become increasingly clear from research that this can only offer part of the solution

to widening and deepening the range of social investment for social entrepreneurs (SQW, 2007).

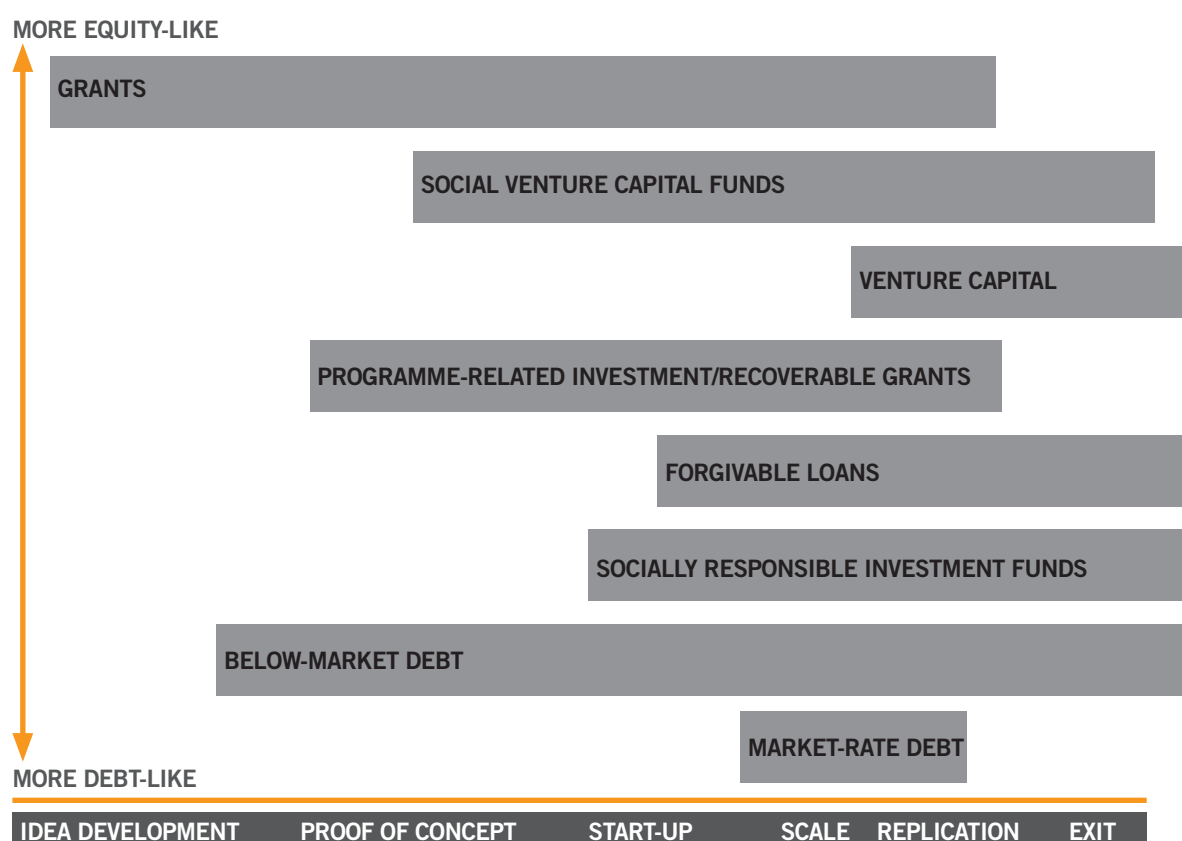
Moreover, the financial needs of social entrepreneurs do not remain static. Many social enterprises' needs move dynamically along the investment spectrum (Figure 3), changing over time and with their organisational lifecycle. If they move along the spectrum towards increasing financial sustainability or profitability, their needs change. Effective social investment, therefore, has to respond to financial need at all points along this spectrum and dynamically within an organisational life cycle – from providing seed or start-up grants, loans and repayable flexible long-term investments (sometimes called quasi-equity), to full-blown commercial equity investment in business growth. Importantly, however, it also has to support the maintenance of enterprises whose economic growth is less steady or assured or inevitably limited by the challenging nature of the social returns they generate. The range of social investment available to social entrepreneurs is set out according to these life cycle issues in Figure 4.

FIGURE 3: SPECTRUM OF SOCIAL ENTREPRENEURSHIP BY RESOURCE STRATEGY
(ADAPTED FROM HOWARD AND GIDDENS, 2004)

SOCIAL RETURN			BLENDED RETURN		FINANCIAL RETURN	
CHARITIES			REVENUE-GENERATING SOCIAL ENTERPRISES		SOCIALLY DRIVEN BUSINESSES	
<i>Revenue Model</i>	No trading revenue	Trading revenue and grants	Potentially sustainable 75% trading revenue	Breakeven – all revenue from trading	Profitable, surplus not distributed	Profit-distributing; social focus
<i>Example</i>	Cancer Research	Guide Dogs for the Blind	Reclaim	Green-Works	Greenwich Leisure Centre*	Cafédirect

* Profits distributed to members/stakeholders only

FIGURE 4: FINANCE OPTIONS FOR SOCIAL ENTREPRENEURS ACROSS THE ORGANISATIONAL LIFE CYCLE (ADAPTED FROM ALTER, 2007)



NATURE OF DEMAND

One way of estimating potential demand is to look at the scale of socially entrepreneurial activity. It is difficult to get an accurate estimate because of the fluidity of definitions of social entrepreneurship, but there are indications of persistent problems for UK social enterprises in accessing finance, particularly those that are small-scale and more likely to be registered as charities. For example, the DTI *Small Business Survey* (2006) estimated around 55,000 social enterprises in the UK, with a turnover of £27bn. This survey included Industrial and Provident Societies (IPs) and Companies Limited by Guarantee (CLGs), and represented 5% of all businesses with employees. A GHK survey (2005), estimated that 15,000 social enterprises were registered as IPs or CLGs, with a total turnover of £18bn. These figures suggest that the 40,000 social enterprises not registered as IPs or CLGs, many of which are likely to have charitable

registration, generate just one-third of the income of social enterprises. They are smaller and less likely to be generating economic surpluses.

Similarly, whilst there are roughly 168,000 registered charities in the UK, with a total income of around £40bn each year, 89% have an annual income of less than £100,000 a year, earning just 5% of the sector's total income. Consequently, only large UK charities are able to access mainstream finance, and held borrowings of around £1.3bn in the UK in 2005. In addition there are between 500,000 and 900,000 small community organisations that have little access to finance, despite often owning property and land assets such as village halls, community centres, historic buildings and open spaces.

Recent comparisons of access to finance between UK social enterprises and small and medium-sized enterprises (SMEs) show that although social enterprise access to loan finance has improved, it is still lagging behind

in important areas. They do significantly less borrowing, experience larger gaps in finance requested and received, need to provide a higher level of loan security, and experience more discouragement. Although social enterprise staff are often more highly qualified academically, they have less business experience than SME staff and are more likely to fail to obtain finance because of the nature of their business. This survey only included social enterprises that were registered as CLGs or IPSs, which tend to be the larger and more economically successful ones. If these problems are being experienced by social enterprises at this end of the scale, it is likely that problems amongst the smaller ones, often registered as charities, must be even more acute. Start-up social enterprises face even more severe problems than established ones. Investors see them as lacking 'investment-readiness', partly because of their small scale, the social nature of the business and their fear of debt (see Harding, 2006; SQW 2007).

The gap in support reported on the demandside by certain types of social enterprise, including smaller start-ups, is reflected on the supplyside by the complaint that there are not enough investment-ready proposals coming forward. Social investment suppliers continue to report a lack of appropriate demand for investment, whether loans or growth finance products (equity-products are discussed further below). Charity Bank recently closed deposits to CITRA, the account that attracts Community Investment Tax Reliefs, for investment in deprived areas, reporting:

'Our loan book has not kept pace with deposit growth. It is a characteristic of this emerging market that few community-banking proposals are waiting to be done.'

(Charity Bank Ltd, 2005)

The UK government's Futurebuilders fund, which supplies flexible hands-on packages of loans, grants and capacity-building advice, has had over £1bn in applications but has committed only £100m. Similarly, the evaluation of the government-supported Adventure Capital Fund (ACF) documents a high level of demand for funds, but a lack of 'investment readiness'

and notes the need to build capacity. It drew attention to the scale of the cultural challenge posed by the shift away from an exclusively grant-based type of fund, with many of its applications couched in terms of a need for gap funding rather than as investment proposals. The authors comment that this challenge to the sector's 'mindset is a further reinforcement of the value of... patient capital initiatives' (Thake, 2003). It should be noted, however, that such readiness might simply denote that organisations are not taking advantage of the best investment structure already available to them.

The potential effect of weakness in capacity on suppressing demand has been widely acknowledged by lenders, government and others (see, for example, OTS, 2006). There have been many national and local government programmes to provide training, support and business help to social enterprise, but inevitably – because social entrepreneurship is new territory – consultancy has been drawn from mainstream business support services. Lyon and Ramsden (2006) found that social enterprises that had received Business Link support benefited measurably, but smaller voluntary-based organisations experience difficulty in accessing support (Pharoah, Scott, and Fisher, 2004). Increasingly, specialist social enterprise lenders and venture philanthropists are becoming engaged in the business development of those whom they support financially and the recent Social Enterprise Action Plan (OTS, 2006) notes the need to make government business advice more inclusive of social enterprise. Building the capacity of those involved in socially entrepreneurial activity is an integral element of building demand for social investment – though this paper cannot review the area of social enterprise business support in detail. The extent to which an element of subsidy at this stage of market development might have a role needs further research. Venture philanthropy and other models of 'engaged' social investment also attempt to address some of these capacity issues (see below).

The discussion of the mismatch between the type of demand coming forward and the type of finance available has focused principally on social entrepreneurship, because this is where most survey data is available. However, in terms of the third sector more broadly, there is an unmet need for

better financing, particularly in relation to capacity building and development, as evidenced by its vastly over-subscribed grant programmes and in many reports, such as *Surer Funding* (ACEVO, 2004) and *Working with the Third Sector* (NAO, 2005).

TYPES OF FINANCE

GRANTS AND PHILANTHROPY

Historically, the third sector developed on the basis of grants, donations and tax relief/subsidy for much of its funding. This had two consequences. First, the effectiveness of third sector organisations was linked to their independence from the state and private sector. Second, as a result of this status the sector generated social and environmental value over and above what is possible for the public and private sectors. Not-for-profits both fill gaps in social and environmental provision (the market failure thesis) and identify new opportunities as a sort of public benefit research and development laboratory. However, this status quo is now changing.

More competition for grants and philanthropy, and changes in public service delivery policy, increasingly enabled third sector organisations to look for contractual product and service income. Weisbrod (1998) noted that the balance of private contributions to US not-for-profit revenue halved over 30 years to the 1990s and this trend has continued. Social entrepreneurship has, to some extent, accelerated this shift away from grants and philanthropy, particularly in the development of social enterprise models that operate in conventional commercial markets. Yet this is only part of the picture. Social purpose organisations continue to use grants and philanthropy extensively, particularly in the start-up or development phase of their projects – without such capital microfinance could never have reached profitability. Grameen Bank is a good example of this (Yunus, 1998; Baue, 2005). However, the nature of grants and philanthropy is changing as more engaged and demanding ‘venture philanthropy’ models emerge (see ‘Supplyside’ below). Creative philanthropy aimed at innovation, scaling and replication as much as project support is also becoming more fashionable (Anheier and Leat, 2006), as are notions of a philanthropic capital ‘market’ (Bernholz, 2004).

The role of government is also evolving from grant-giver to purchaser of contractual services (see DTI, 2003; Emerson and Carttar, 2003). Such contracts provided 50% of UK charity income in 2006 (NCVO, 2007). This is driving social purpose organisations towards more efficient and responsive service delivery models, but could seriously compromise the historic independence of the sector noted above. If social entrepreneurship simply becomes an arm of the state then its ability to innovate and be performance driven must be questioned.

DEBT AND DEBT-LIKE FINANCE (QUASI-EQUITY)

There appears to be a significant misunderstanding of the value and efficiency of debt financing across many social organisations. A survey of social enterprises that have grown out of existing charities illustrates this:

- ‘Our board believe that if you have not got the money to run your charity, you have no way of paying a loan back’
- ‘It is not a process that we are familiar with, so I think that would present a barrier with the trustees and staff who may be resistant to change’
- ‘We do not expect... supporters to service debts’

Such comments are supported by data from the Bank of England (2003) survey of social investment that found a strong aversion to debt mechanisms – other than conventional and inefficient bank overdrafts – even when the risk levels were low and they offered more flexible financing. Although take-up of debt finance appears to have increased, there is still a gap between social entrepreneurship and conventional small and medium-sized enterprise practice. The most recent GEM survey (Harding, 2006) also noted that many social entrepreneurs use their own credit cards rather than bank debt to fund start-up or growth activity – perhaps the least efficient mechanism available. A lack of financial literacy is clearly an issue here, as well as a strong sense of a ‘duty of trust’ to avoid any risk on the part of management.

Furthermore, debt is insufficient for all financing needs. It requires a level of security

⁵ Patient capital is defined as ‘forms of investment which are intended to achieve social benefits whilst also generating a financial return, but are neither a straightforward grant, nor commercial loan transaction.’ (Civil Renewal Unit, 2004)

that many organisations do not have, tends to be short-term and is unlikely to fund all the costs of new projects. The Bank of England (2003) highlighted the need for a variety of forms of debt to provide long-term investment at appropriate and mutually agreed rates of return. Of particular importance was the absence of subordinated, interest-free or reduced interest ‘patient’ finance.⁵ In reality many social enterprise organisations have legal structures that prevent full-blown, for-profit, commercial equity investment, and the kinds of growth investment products that they need are extended types of loan, such as loans with different repayment structures, loans on very long terms, or even repayable grants on highly flexible terms. Such engaged and patient finance is also sometimes known as ‘quasi-equity’ when it functions more like an ownership stake, eg with board representation and other capacity-building support bolted on, than an impersonal fixed-rate income mechanism.

There is little data about the demand for specific patient finance products, other than the general difficulty in accessing appropriate finance reported in the surveys mentioned above, which mirrors experiences in the small and medium-sized enterprise market (Harding, 2000; Bannock Consulting, 2001). The government’s evaluation of the Adventure Capital Fund (2005) provided evidence of a need for flexible funding on easy terms, and the Department of Trade and Industry (DTI) *Small Business Survey* of 2006 found that increased use of commercial finance amongst social enterprises correlates with reduced dependency on grants.

Triodos Bank – a social investment specialist – has experienced some unmet demand for below market-rate investment. Moreover, Bridges Community Ventures (Howard and Giddens, 2004) estimated the unmet demand for quasi-equity at around 150-180 high-potential social ventures, basing its assessments on the fact that just 5-6% of small and medium-sized enterprises access venture capital finance. At the time of producing its research on the need for a social venture capital fund, Bridges had seen about 40 potential candidates. Foursome, a for-profit social venture capital company supports about 20 enterprises. BigInvest, a social investment company set up by a charity, has noted fast growth in demand for its very new investment fund (2005) and is looking for finance to expand its offering. The Adventure Capital Fund has experienced high levels of demand, but a lack of investment-readiness.

However, there is a limited bond ‘market’ in social enterprises that are organised primarily as co-operatives or Industrial and Provident Societies. This market shows promise for future development. Five bond issues have been undertaken so far: Shared Interest, City Life, Golden Lane Housing, ICOF and Out of This World (Hartzell, 2007).

Internationally, the reticence to take debt finance is also clear, as is the need for capacity building around financial literacy across not-for-profits (see, for example, Miller, 2001, 2005).

EQUITY

An important method of raising finance in business is through a share issue. However,

TABLE 3: NUMBER OF EQUITY ISSUES AND TOTAL FUNDS RAISED (FROM HARTZELL, 2007)

PERIOD	NUMBER OF ISSUES	TOTAL RAISED (£ MILLION)
1984-1990	6	3.35
1991-1995	8	4.17
1996-2000	13	10.55
2001-2005	16	32.03
TOTAL	43	50.1

this is much less straightforward for social purpose organisations. First, shares are usually a mechanism to assign organisational wealth to investors and this is typically contra the strategic objectives of most social entrepreneurs. Second, and related to this, there are problematic issues around ownership and control, with many social purpose organisations unprepared to risk mission drift in order to raise share capital. Third, much of the third sector has a traditional aversion to financial speculation and profiteering, which makes the trading of 'social' shares difficult under conventional conditions. Fourth, relatively few social enterprises are at a scale where they can offer dividends (and may object to this anyway). Nevertheless, the rate of growth of 'Alternative' Public Offerings (APOs) is increasing (see Table 3).

To date there have been several social enterprises that have offered share equity to the market. These are all PLCs and seven are still trading. This pioneering group consists of: Traidcraft; The Triodos Renewable Energy Fund; The Ethical Property Company; Good Energy; cafédirect; Triodos Bank NV; and the Centre for Alternative Technology (Hartzell, 2007) (see Table 4). None of these stocks are traded on the conventional exchanges (LSE, AIM, OFEX), listing instead on ETHEX, a matched 'swaps' market run by Triodos Bank. All have significant ownership restrictions in place to protect their mission integrity. Such activity suggests that the further development of a social equity finance stock exchange may be a possibility, both to provide a secondary market for social enterprise stock and to provide new fundraising opportunities to social and environmental companies through APOs.

It is clear that there are a growing number of social enterprises that could consider an APO. However, in the absence of a developed exchange/stock market there are still considerable institutional barriers to such activity (see below). Furthermore, the investee culture across the third sector is still highly sceptical

SUMMARY: DEMANDSIDE

- The finance requirements for social purpose organisations are highly specialised and need to encompass multiple social and economic objectives as well as qualities such as innovation, inclusion, growth potential and sustainable social change.
- Such finance needs to be flexible and responsive to the different income generation and growth potentials of organisations operating across the social investment spectrum.
- Only partial information is currently available on the performance of social purpose organisations in terms of social, financial and blended returns.
- Grants will always be an important source of early stage and growth investment for social purpose organisations. This may take the form of 'venture' philanthropy for small-scale and start-up activities, where social and financial returns may be perceived to be at higher risk.
- Government contracts are an increasingly important source of funding.
- There is a misunderstanding of the value and efficiency of debt financing amongst many of the organisations in the investee population, coupled with a strong risk-aversion to financial innovation.
- The demand for appropriate capital for social investment may be suppressed by lack of capacity and appropriate finance products.
- Better market data on the real level of demand for investment finance at affordable rates is needed.
- Some social enterprises are reaching a scale where they need access to higher levels of investment from an appropriate market in social equity finance of the kind discussed by Hartzell, the New Economics Foundation and others.

**TABLE 4: SOCIAL ENTERPRISE PUBLIC EQUITY OFFERINGS
(FROM HARTZELL, 2007)**

Company	Date	Legal form	Type of investment	PLC	Amount raised
Traidcraft	1984	PLC	Share		(£m)
Mercury Provident	1985	PLC	Share		0.3
Traidcraft	1986	PLC	Share		0.5
Paperback	1987	IPS	Loan stock		1
ICOFund	1987	IPS	Loan stock		0.05
Centre for Alternative Technology	1990	PLC	Share		0.5
Mercury Provident	1991	PLC	Share		1
Traidcraft	1991	PLC	Share		0.4
Ecological Trading Company	1993	PLC	Share		0.4
ICOF Community Capital	1994	IPS	Withdrawable share capital		0.2
Paperback	1994	IPS	Loan stock		0.45
Out of This World	1995	IPS	Loan stock		0.07
Shared Interest	1995	IPS	5-year loan stock		1
Wind Fund PLC	1995	PLC	Share		0.65
Bay Wind	1996	IPS	Withdrawable share capital		1
Out of This World	1996	IPS	Loan stock		1.2
Shared Interest	1996	IPS	5-year loan stock		0.2
Aston Reinvestment Trust	1997	IPS	Withdrawable share capital		0.85
Out of This World	1997	IPS	Loan stock		0.41
Shared Interest	1997	IPS	5-year loan stock		0.2
ICOFund	1997	IPS	10-year loan stock		1.2
Wind Fund PLC	1998	PLC	Share		1
The Phone Co-op	1999	IPS	Withdrawable share capital		1.3
Baywind	1999	IPS	Withdrawable share capital		0.4
Ethical Property Company	1999	PLC	Share		0.67
Shared Interest	1999	IPS	5-year loan stock		1.32
Citylife (Sheffield)	1999	IPS	5-year bond		1
Monkton Group (Good Energy)	2001	PLC	Share		0.8
Shared Interest	2001	IPS	5-year loan stock		0.66
Citylife (Newcastle)	2001	IPS	5-year bond		1
Traidcraft	2002	PLC	Share		
Ethical Property Company	2002	PLC	Share		3.25
Shared Interest	2002	IPS	5-year loan stock		
London Rebuilding Society	2002	IPS	Withdrawable share capital		1
Citylife (East London)	2002	IPS	5-year bond		
Unicorn Wholefoods	2003	IPS	Loan stock		1.9
Shared Interest	2003	IPS	5-year loan stock		0.3
Golden Lane Housing	2003	Charity	10-year bond		1
Cafédirect	2004	PLC	Share		1.5
Monkton Group (Good Energy)	2004	PLC			5
Shared Interest	2005	IPS			0.66
Triodos Renewable Energy Fund (formerly Wind Fund PLC)	2005	PLC	Share		1 4.75
Westmill Wind Farm	2005	IPS	Share		3.75
Total					50.1

INTERMEDIARIES

The development of an appropriate intermediary infrastructure that would address some of the demandside issues identified above and of the supplyside (see below) remains central to the achievement of a successful social investment market. Such organisations broker supply into demand, as well as help create market demand.⁶ A number of new social investment intermediary agencies have emerged, offering a range of specialised client services, mainly to potential investors. These services include generic and tailored information on social investment opportunities, advice and full investment management. But many of these services focus on gifts and grants rather than new forms of investment. New intermediaries are already playing a wide range of roles in the provision of information and advice to donors and funders,

researching investment prospects and measuring/benchmarking comparative performance, brokering deals and managing and distributing funds. Table 5 (see next page) sets out some examples of intermediation agencies within the social investment field, UK and international, and the services they provide.

The provider examples do not sit exclusively in one category of service, and several could be placed in more than one.

Whilst such developments are central to the ongoing growth in volumes of social investment reaching social purpose organisations, much remains to be done to reach more conventional sources of finance outside the core social and ethical investor marketplace. To achieve this many gaps in information and market structure will have to be addressed.

⁶ It is also worth noting that many organisations, particularly charities and NGOs, have embedded intermediaries. These are internal fundraisers who liaise directly with sources of capital, typically donors. This group will not be considered further here since it represents a function of the demandside rather than a separate part of the wider institutional landscape.

TABLE 5: EXAMPLES OF SOCIAL INVESTMENT INTERMEDIARIES

INTERMEDIARY SERVICE	EXAMPLES OF PROVIDER
Banking	CDFI, Credit Union, Charity Bank, Triodos
Information on investors	EIRIS
Microfinance wholesale	ACCION, Blue Orchard
NGO/social enterprise information platform and research	REDF, GuideStar, New Philanthropy Capital, Social Enterprise Coalition
Performance measurement	New Economics Foundation
Generic market reports	REDF, GEM
Accreditation	Ethical Investment Association of Australasia
Validation	GlobalGiving, GiveIndia, Greater Good South Africa, CAF
Donor advice/portfolio planning	Rockefeller Philanthropy Advisors, WISE, The Philanthropic Initiative
Online advice and brokerage	Investing for Good (2006)
Share-dealing/brokerage	Ethex, Aim, Plus Markets Group
Total client investment management	Geneva Global, GEXSI, UBS
Managed social investment/venture philanthropy funds	Venture Philanthropy Partners, ARK, Venturesome, Ashoka, Social Venture Capital Foundation, NESsT, Venture Fund, Impetus, New Profit Inc
Intermediary and donor networking/information-sharing	Global Philanthropists Circle, The Funding Network

FUNCTIONS OF INTERMEDIARIES **INFORMATION PROVISION**

A prime need for the development of more effective flows of social investment is better information of all kinds. For example, a social equity finance exchange requires comparative information on types of organisation and their performance. Social investment intermediaries are already making use of various approaches to comparative investee information, validation and performance benchmarking. These approaches are facilitating the flow of social investment in many different ways, but they do not provide any kind of market standard, because they are fragmented, small-scale and largely

designed to meet individual stakeholder preferences. They are also costly, generally tackling investee assessment on a one-to-one basis. The challenge of providing comparable standardised information on social purpose organisations should not be underestimated. In practice, however, a number of individual tools and approaches have been designed and are already in use: these could already provide a well-developed starting-point for a more formal index. Such performance measures include:

- Social Auditing (Zadek, 1998)
- Triple Bottom Line (Elkington, 1997, 2001)

- Family of Measures (Sawhill and Williamson, 2001)
- Balanced Scorecard (Kaplan and Norton, 1996; Kaplan, 2002, Paton 2003)
- Social Return on Investment: SROI (Emerson, 1999, 2003; Nicholls, 2004; Mackenzie and Nicholls, 2004)
- Brand Valuation

These models vary from the highly descriptive and qualitative (Social Auditing) to the highly quantitative (SROI) and are best used in combination. However, even with such methodologies there will always be the need for bespoke metrics that reflect the individual mission

and organisational approach. Here effective reporting is driven by transparency (an open and accountable design process), consistency (using the same metrics longitudinally), and relevance (not simply measuring what is easy to measure). (See Table 6.)

The relationship between measurement and performance evaluation is central to the socially entrepreneurial model. An additional dimension comes with accountability for the use of resources and for impact with beneficiaries. Nicholls (2008) suggests an intrinsic link between performance, impact and accountability via a model of organisational legitimacy that connects inputs and outcomes. Such an analysis defines an organisation's right to operate and is a key resource strategy, since trust and reputation are key assets driving many funding sources for social purpose organisations.

TABLE 6: APPROACHES TO PERFORMANCE MEASUREMENT USED FOR SOCIAL ENTERPRISE

PERFORMANCE MEASUREMENT	DESCRIPTION
Triple Bottom Line	This model requires an organisation's accounting system to incorporate not only the traditional measures of financial performance, but also social and environmental outcomes.
Family of Measures	This model is built around three sets of linked metrics: impact measures, activity measures and capacity measures.
Blended Value	Blended value represents the conceptualisation of organisational output as a single metric factoring in all economic, social and environmental value. This develops the Triple Bottom Line approach.
Social Auditing	Social audits or accounts capture subjective user and other stakeholder experience along with any quantitative measures.
Balanced Scorecard	The balanced scorecard approach rates organisational performance against a broad basket of financial and social indicators, including staff policies.
Social Return on Investment	SROI aims to monetise all social and environmental outcomes and combine them with economic outputs to provide a single financial output figure. This is then discounted by time and risk and compared with (similarly discounted) input costs to produce a social ROI.
Branding Valuation	Building a strong ethical or environmental brand can add value to a social enterprise and act as an intangible asset for borrowing or equity price setting.

STANDARDISATION

The challenges of standardisation should not be underestimated. The Global Exchange for Social Investment (GEXSI), as originally conceived, presented a highly ambitious model for providing major investors at a global level with a standardised market of professionally screened and benchmarked investment prospects. De facto it represented the basis for a social stock exchange. The difficulties that the model presented are fully documented in a recent case study (Hartigan, 2006), and highlight problems such as lack of grassroots consensus on performance criteria established largely by investors, and the failure of an accreditation process to generate deals. This was particularly disappointing for prospects that had invested scarce time and resources by participating in the accreditation process.

The development of sets of criteria for use in assessing a narrowly defined social enterprise subset of profit-making social businesses may be feasible. One investor recently called for a *common language and a common shop window* if mainstream investors are to get interested in investing in new business entities (cf Alter, 2006).

This may mean clarifying that the same language sometimes means different things when used by different people. Different kinds of public, philanthropic and commercial investors look at the potential marketplace in different ways. For example, Unwin (2006) takes a much more holistic view of the 'social investment marketplace' than is taken in the New Economics Foundation/Charities Aid Foundation (2006) study, and encompasses a breadth of social enterprise and finance provision. To stimulate market development, Unwin recommends a web portal that would help applicants find the right sorts of finance, in the most cost-effective fashion. In contrast, the New Economics Foundation/Charities Aid Foundation model focuses on the information needs of potential investors in social business.

There are different views between the papers about the priorities for intermediary development at this stage of the market. The New Economics Foundation/Charities Aid Foundation (2006) paper recommends identifying specialist advisers to act as intermediaries and assume responsibility for due diligence and accreditation. Unwin (2006), on the other hand, recommends more of a

support and matchmaking role initially, and makes the very important point that there has to be a firewall between this role and that of assessment, appraisal and due diligence. The paper comments that greater information and information-sharing between different types of funder:

'are considered to be a more appropriate first step than attempting to establish any institutional form of intermediary body at this stage. This approach is an incremental and organic one, allowing for changes in existing practice rather than institutional change... the umbrella bodies, accountants, lawyers, fundraising consultants and others are relatively unused to these new forms of finance, and do not provide ready navigation for applicants. Equally, many of them are not persuaded that alternatives to grants in order to access finance are in the interests of the voluntary organisations they serve'.

But the language of social investment discussion needs to make social investment distinctions clear. To develop policy it is important to know, for example, whether the language differences imply different perceptions of the way in which the social investment market should be developed.

Social investment intermediaries also have important roles to play in terms of the syndication of deals (Wood and Martin, 2006) and placing investments (Emerson and Spitzer, 2007). Such institutions can play a crucial part in institutionalising risk-return calculations that are currently very poorly understood in the social sector. Better provision of comparative information – as mentioned above – combined with the ability to offer investors diversification strategies across the social investment landscape would significantly widen the appeal of social investment.

DEVELOPING A SOCIAL/ETHICAL STOCK EXCHANGE

The development of an index, designated classification or registration of some kind for social enterprises would provide one way of flagging up investment opportunities and the kinds of returns to expect. It would provide some of the transparency, standardisation and accreditation that would give investors confidence. The idea was first explored as long ago as 2000 (Emerson and Wachowicz, 2000), but has yet to gain traction.

Existing alternative market listings for companies in emerging, ethical and social sectors could provide a precedent and basis for a new social enterprise listing. A number of social enterprises are already listed on alternative indexes such as AIM, for small and medium-sized enterprises, and PLUS Markets Group (formerly OFEX) and the embryonic share market EtheX, founded by Triodos, for unlisted equity offerings with individual investors operating through a matched bargain process run through a designated broker. Other alternative listings include the FTSE4GOOD, which measures the performance of companies that meet SRI standards, and Sharemark, which deals in shares for small and unlisted companies at a single price. A different and less formal approach to creating a class identity is the NEF 100 (2004), published from 2001-04, which listed the fastest-growing inner-city firms that met a range of social criteria.

The right approach needs to be evolved for social investments, and there are some complex issues. Hartzell (2007) provides the most authoritative account of a process for establishing a 'social' stock market. The CAF/NEF (2006) report also considers how to set up a social finance market exchange. The first ever public share issue undertaken by a social enterprise was by Traidcraft in 1984. Since then there has been a steady increase in the number of such Alternative Public Offerings (see above), but the process of putting together an APO and of setting up the subsequent trading mechanisms remains haphazard and uncoordinated. It may now be the case that the public appetite for such offers has developed to a point where a social stock market may be feasible, but to attract APOs and social investors such a market would have to be quite different from existing markets.

■ According to Hartzell (2007), an 'ethical' exchange would need to be structured to protect against exploitation or speculation yet have sufficient liquidity to function. This will be a major challenge, since well functioning modern exchanges typically institutionalise speculation. Furthermore, it is unlikely that such a restricted market would be managed by an existing financial institution recognised by the Financial Services Authority. A final implication of this is that pricing decisions would remain contested and, in the absence of speculation, would most likely have to be set rather than float

■ The ownership structure would have to conform with the ethical expectations of those listed and investors

■ Such an exchange would need to be self-financing, but probably could not charge market rates

Partnering with an existing exchange, and creating a sub-index, would probably be the least costly way forward, but there are challenges. One view is that social enterprises occur in every asset class and across all industries, so it should not be a separate asset class. Furthermore, social enterprise is not a regulated company form so there are questions about how criteria for inclusion/exclusion would be set. While the Community Interest Company (CIC: see below) would meet this criterion, and investors would know what to expect of such companies, a listing limited to CICs would exclude many other social purpose organisations. As discussed above, another major challenge for a listed social enterprise is ownership, the risk of takeover and loss of social value or control over mission. There are other downside challenges too, including the costs of a listing and the difficulty of getting an adequate valuation of the social aspects of the business

An index for tracking performance in this fairly small and diverse marketplace, however, is probably not meaningful at this stage, and not suitable for companies with a social mission. One approach would be active stock picking. Even with an exchange listing, social investments are likely to remain the preserve of the active investor, and the costs of investment will remain high until more finance flows into the market and the number of high-quality projects has increased (Inderst and Müller, 2004). The development of more specific accreditation and benchmarking criteria or listing rules in themselves would create a better understanding of the nature and value of social business. They could help strengthen the image of social enterprise as an investment prospect more generally.

The CAF/NEF (2006) report proposed that there were a number of barriers to the creation of a social equity finance market:

■ Shortcomings in the intermediary infrastructure

■ Lack of transparency of terminology

■ No standard measurement of returns and performance

⁷ See further: www.cabinetoffice.gov.uk/third_sector/news/news_stories/080227_riskcapital.aspx

⁸ See further: www.culturalshift.com

- No regular reporting
- Little financial regulation
- Unclear relationship between risk and return
- Little liquidity and low deal flow
- Few exit strategies

Exit strategies are particularly problematic, since there will typically be complex ownership and valuation issues to resolve (how to deal with grants, for example), as well as mission-driven imperatives (see Alter, Shoemaker, Tuan and Emerson, 2001).

Nevertheless, despite all this, several projects are in play to develop such an exchange, including a £500,000 investment into a feasibility study to be piloted by the New Economics Foundation/Charities Aid Foundation. Moreover, the development of carbon exchanges worldwide demonstrates that markets can come into being composed of assets that were once not recognised as having either value or being tradable.

ENABLING INSTITUTIONS

GOVERNMENT

The UK government has taken a number of initiatives to create a legal and fiscal framework for the development of social investment, as well as to stimulate supply and demand. The principal ones are:

- The Phoenix Fund (2002) that capitalised the CDFIs (see below), and Bridges Community Ventures Ltd, the first fund to provide investment specifically for small businesses in deprived areas: it was founded by the venture capitalists Sir Ronald Cohen (Apax Partners, 3I) and Tom Singh (New Look) in May 2002. It initially raised £20m from the private sector and £20m in government matching investment, and started investing a second fund in 2006.
- Community Investment Tax Relief or CITR (2003) provides investors with an income tax break on investment in social purpose organisations in deprived areas. It has contributed around around

£40m to CDFIs in the UK, which had a loan portfolio of 181m in 2005 (CDFI, 2005).

- Futurebuilders (2005), worth £215m, offers investment packages of grants, loans and technical support for selected organisations with reasonable prospects of winning service delivery contracts.
- The Adventure Capital Fund (2002), worth £15m, offers longer-term financial and development investment to support community enterprise growth.
- Two pilot funds (2006), worth £200,000, for innovation in encouraging private sector investment in social enterprise.
- A £10m venture fund for social enterprise (2006) in recognition of the need to stimulate growth.⁷
- A Community Asset Transfer fund of £30m to help local authorities transfer assets into community ownership.

As well as these supplyside interventions, government has developed other policy innovations of relevance to social investment. These include:

- Longer-term contracting between government and social enterprises (DTI, 2003).
- The formation of a Social Enterprise Unit (see DTI, 2002), now incorporated within the Office of the Third Sector.
- The establishment of an Office of the Third Sector, within the Cabinet Office, with its own minister (see OTS, 2006).

In addition to the above funds and initiatives, government-supported training and infrastructure has rolled out across regional and local authorities, leading to numerous localised social enterprise growth strategies and funds. The European Union EQUAL-funded 'Cultural Shift' programme overseen by the South East of England Development Agency (SEEDA) is a good example of such a project.⁸ This new infrastructure has

largely involved re-framing existing economic development activity, although social enterprise provision of local recycling and childcare services has been particularly successful.

COMMUNITY INTEREST COMPANY (CIC)

One of the most significant government initiatives to support social enterprise has been the establishment of an entirely new legal form – the Community Interest Company (DTI, 2004). CICs are a potential new source of demand for social investment. As noted earlier, socially purpose organisations are in the strong position of being able, at various stages of development and for various purposes, to access finance from commercial, public and philanthropic sources. However, the regulations and expectations around the uses of finance from these sources are different, which can lead to complex and fragmented organisational structures, lack of clarity of purpose to funders and restrictions on activities. To address some of the problems, a new company form, the Community Interest Company (CIC), was established in the UK. If registered as a company limited by shares or as a public limited company, the CIC can provide protection for public or philanthropic assets while also being able to issue shares and pay dividends to commercial investors. Its asset lock means that any philanthropic or public investment continues to be maintained in the public interest in perpetuity, preventing investors from sharing any residual assets, beyond the paid-up value of their shares, if the social enterprise is sold or wound up.

The attractiveness of the CIC model for multi-stakeholder social purpose enterprises can be seen in the fact that in the first 18 months after the CIC Registry opened more than 600 organisations were registered. A formal review of the CIC framework is already under way and many in the third sector believe that CICs should attract tax-breaks similar to those enjoyed by charities. Some potential investors believe that the cap on shares might suppress growth. The likely demand of CICs for equity finance and potential deal flow is unknown at this stage, but their potential needs to be factored into thinking about future demand for social investment, particularly as their design is specifically intended to facilitate equity investment.

What can be learned about the social investment landscape from such initiatives? It was noted earlier that Adventure Capital Fund and Futurebuilders have experienced lack of investment-readiness and slow fund dispersal. This has been attributed to demand failure – but this is not a complete explanation. These funds have tightly drawn investment criteria, in relation to programme themes, prospects for obtaining contracts and ability to repay loans. Futurebuilders has now been allowed to relax the rules around themes and extend its remit. Such funds are flexible, but government funds cannot take a high-risk approach and there is some pressure to show early returns. Risk is mitigated principally in the investee selection process. This is different from venture capital investment models, where the investor shares the risk and the finance is related to organisational need rather than external policy criteria. As noted, Bridges Community Ventures, which was partly a pilot fund to test need, established that there was considerable demand for sub-market commercial finance amongst social enterprise activities that lay outside its investment criteria as a public-private partnership (Howard and Giddens, 2004). These experiences raise the question of how far philanthropic funding is a necessary third partner, without the constraints of public and private funders, in creating a social investment market with funding for all stages and types of enterprise need.

SUMMARY: INTERMEDIARIES

- Greater standardisation in the comparative performance information provided by intermediaries would be helpful to some types of investor.
- More regular, public, reporting on performance would be helpful to some types of investor.
- Standardisation in the language/terms used to refer to social purpose organisations would reduce the current heterogeneity of available deals.
- The high costs associated with the currently fragmented and individualised nature of intermediary services within the social investment marketplace remain a barrier to new investors and investees.

- The current landscape lacks any kind of developed market exchange mechanism for investments in social purpose organisations.
- The social investment market has been given a strong steer by supplyside government initiatives. Aimed principally at stimulating social enterprise organisations, these have included tax incentives for social investment, specialised investment funds, dedicated social enterprise policy, training and business support, a new Community Interest Company form aimed at widening the scope for share issues and attracting both public and private finance, and ring-fenced public services market opportunities to generate demand. These initiatives have created a framework for the development of social investment, but there remains a problem of investment readiness in some cases. Furthermore, the currently available data on social enterprises is patchy and contested with the result that it is impossible to judge just how effective these initiatives have been thus far.
- Although many commentators believe that further government subsidy is needed to grow the range and depth of social investment, the diversity of investee types means that uncertainties surround its potential role in the current stage of the market.

SUPPLYSIDE

SOCIAL INVESTORS

The potential market for social investors is currently hard to gauge. To date it has largely consisted of government and foundation grant-makers and ethical shareholders (a segment worth less than 1% of total third sector funding). There is little research on the scope for social investment, and this section will simply note the range of possible types of donor and funder. There is enough evidence from the emerging market to show wide potential across the funding landscape. Statutory agencies are likely to remain important investors for some time because of their responsibilities for social welfare, but since so much service provision takes place at the local level, the interest of local statutory agencies and authorities of all kinds in supporting local organisations will be a key determinant of finance supply. Local authority interest is currently variable.

A number of private bankers are involving individual high net worth clients in venture philanthropy through specialised pooled funds, CDFI or individual enterprises (Martin, 2006). Some new venture philanthropic funds have also been

set up (EVPA, 2006). Turning to the mass affluent, the Ethical Property Company, for example, has attracted 20,000 small investors to its share offers (Edey, 2006). Fair trade sales alone are now more than £2bn globally per annum, £290m in the UK (Nicholls and Opal, 2006; Nicholls, 2007).

The most recent Co-operative Bank Ethical Purchasing Index valued the ethical 'sector' in the UK in 2005 at £29.3bn (+11% on 2004) with the fastest growth in consumer goods being sustainable fish (+54.5%), fair trade products (+38.3%) and organic food (+17%). IGD International has predicted that with the arrival of Whole Foods Market in the UK in 2007 sales of premium organic products will grow by £6bn to reach £19bn annually by 2011. IGD also suggested that the organic and fair trade markets are going to increase by 50% and 100% respectively by the same year. Ethical investments now command an important subsector of the total portfolios under management globally, amounting to £1.4 trillion in the USA and £11.6bn in the UK (2006). According to Fidelity's FundsNetwork, demand for ethical investment

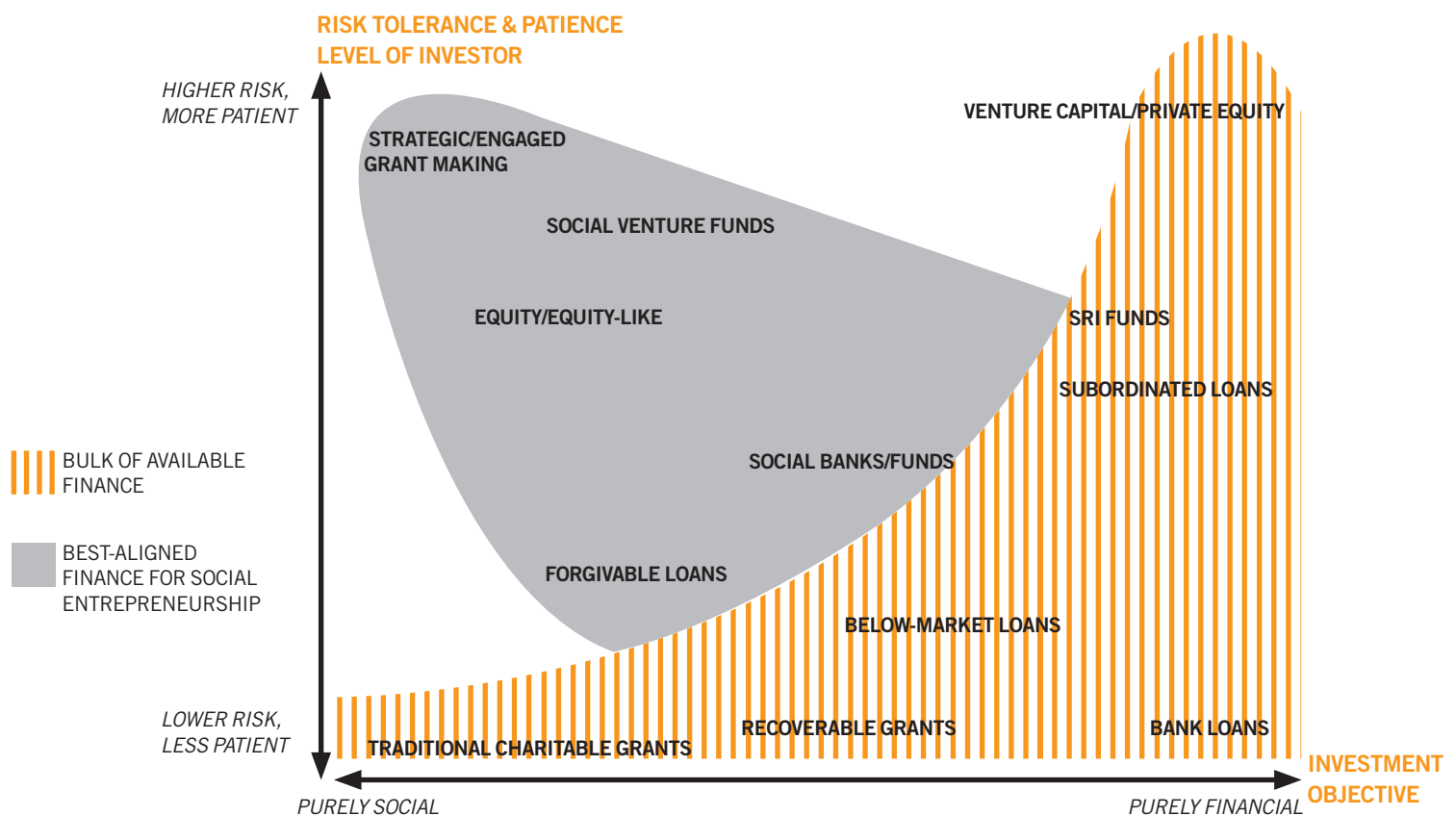
funds rose by 80% in the first four months of 2007 when compared with the same period in 2006. Mainstream investors too are increasingly moving into the ethical investment sector as it out-performs the main market.

Charitable trusts are a major potential market segment. Some are beginning to invest their charitable endowments in ethical or socially responsible funds, and churches have been doing so for years. In the UK, the Charity Commission has sanctioned Mission Related Investment (MRI), but, for a number of reasons, the approach will take time to bed down. The opportunity here is huge, with charities having £80bn of assets under management to draw upon for MRI. However, it presents more complex investment decision-making for trustees, there is little standard market information to guide investment in social business and it requires new investment management expertise.

European foundation interest may receive a major boost with the publication of the PRIME Toolkit (Primer for Responsible Investment Management of Endowments) by Eurosif (2006). It provides clear and comprehensive guidance for trusts on ethical and mission-related investment, with examples of financial metrics and criteria, and was sponsored by a sizeable group of major international foundations. A special investment fund for European foundations has been created by IDEAM, the SRI subsidiary of the Credit Agricole Group; the Swedish MISTRA Foundation is its first investor, with a stake of Euros 20m. EIRIS/UKSIF (2006a; 2006b) published new guidance on responsible investment approaches to non-equity investments and common investment funds for charity trustees.

The landscape of social investment opportunities is set out in Figure 5. This organises

FIGURE 5: INVESTMENT OPPORTUNITIES IN SOCIAL INVESTMENT
(ADAPTED FROM ALTER, 2007)



the various investment options according to two axes: the type of return that an investor is looking for (purely social – purely financial) and the risk profile of the investment in terms of it achieving its financial or social returns. What is clear is that the bulk of the social investment currently available does not best suit the emergent needs of social entrepreneurs.

INVESTMENT INSTRUMENTS AND INSTITUTIONS GRANTS

Philanthropic funds are both driving and being driven by new thinking about the role for entrepreneurialism in achieving social change. Charitable trusts and foundations are already heavily invested in social enterprises, mainly through grants and donations, so they have significant power to generate change in the way in which funds are used. Pioneering groups such as ASHOKA, REDF (formerly Roberts Enterprise Development Fund), Bridgespan, the FB Heron Foundation (FB Heron Foundation, 2004), the Social Investment Task Force (2005) and, more recently, the European Venture Philanthropy Association (EVPA 2006), have challenged current investment and grant-making practice. They have called for foundations to apply their funds to more innovative and transformative models of social change – ones that are replicable and economically sustainable in the long-term. They see trusts as ‘social investors’ rather than donors, and believe that philanthropic funds can be managed to greater effect.

There are a number of ways in which charitable endowed trusts and foundations can seek to manage their funds more actively to achieve social aims:

- To move towards ethical or Socially Responsible Investment (SRI) of charitable endowments, with the income given as grants for social purposes or reinvested in social business and enterprises.
- To increase Mission-Related Investment (MRI) or Programme-Related Investment (PRI). This involves trusts investing their finance or income in social businesses which are able to return an acceptable or close-to-market rate and whose work fits in with their mission (the investment would appear on their balance sheet).
- To engage in Venture Philanthropy modelled on venture capital approaches, involving a mix

of advice, support and funding given as loans, returnable grants, patient finance, etc, but not necessarily requiring a financial return.

Trusts and foundations have played an important role in developing the community finance intermediary infrastructure, providing 14% of the revenue funding and 3% of the finance within CDFIs in the UK. A number of UK and European trusts are involved in MRIs and loans, including the Tudor Trust and Esmée Fairbairn, and in loan guarantees to individuals and social businesses falling within their selected beneficiary groups, for loans provided by a mainstream bank. Pepin (2004; Tranquada and Pepin, 2005) believes that foundations could invest in commercial enterprises operated by charities and their trading or holding companies. Third sector organisations have a strong track record in trading, and there are many opportunities for trusts to invest in sustainable income-generating ventures. Overall, however, in spite of some exciting initiatives, social investment represents a very small part of the grants portfolio of foundations.

VENTURE PHILANTHROPY

New ‘venture philanthropists’ such as Venture Philanthropy Partners, Impetus, New Philanthropy Capital, Geneva Global, and Ark are bringing new investment cultures and tools to philanthropy, particularly from venture capital models, including:

- A highly engaged model of funding and business support
- Flexible long-term investment, sometimes repayable
- Active seeking out of investees with growth prospects, either social or economic
- Assessment of achievement by output indicators
- Regular monitoring to targets
- Assessment by financial sustainability and funds leveraged

(See REDF, 1999; Grenier, 2006.)

Venture Philanthropy Partners, for example, brings a full-blooded venture capital approach.

It suggests that it is applying the same entrepreneurial spirit that brought it success in the for-profit arena to its innovative philanthropic efforts. It talks of its investment portfolio, of philanthropic investments in high-potential nonprofit organisations and of investment for different stages of the investment cycle.

(2006) recently commented that the analogy between venture philanthropy and venture capital is not helpful if stretched too far, even if ex-venture capitalists are largely responsible for the emergence of venture philanthropy. John (2006) believes this can lead to a misunderstanding that venture philanthropy always seeks a financial return on capital, whereas the vast bulk of US venture philanthropy is based on non-returnable grants, even where ambiguous language such as 'philanthropic investment' is used (John, 2006). On the whole, US experience seems to place greater emphasis on social innovation than financial innovation – whereas the opposite is true of most UK literature. Social entrepreneurship is associated with innovation, progressiveness, sustainability, cost-effectiveness, empowerment, reproducibility, addressing poverty and, sometimes – though not necessarily – income generation.

Full treatment of venture philanthropy can be found in REDF (1999), John (2006) and other publications, including Bolton and Kingston (2006), Eurosif (2006), Esmée Fairbairn Foundation (2005) – this paper will not cover them in detail. The EVPA, set up in 2003 by five executives from the European venture capital equity industry and already representing an impressive range of European funders, recently published a fairly comprehensive *Directory of Venture Philanthropy* (2006), and a Social Investment Group has been set up by the European Foundation Centre (see www.efc.be).

This review of developments leads to the view that contradictory attitudes towards risk are emerging amongst philanthropic funders. Some argue that since philanthropic grants have no mandate to make a financial return, they can afford to take 100% risk. This means that philanthropic funds could afford to play a bigger role in high-risk social venture funding where relevant to their mission. They could fund embryonic start-up entrepreneurialism in social purpose organisations, business development and growth finance where surplus or profit generation looks promising but not

robust enough to attract mainstream commercial investment. In other words, philanthropic funds could – and some believe *should* – step into the risk gap left by private and public funders. But what can be seen in the approaches of many of the new venture philanthropists is an obsession with addressing risk and guaranteeing investor returns. They are generating higher requirements in relation to performance, reporting and return than ever seen before amongst social enterprises. Is philanthropic social investment really about risk or safety?

DEBT

A debt market for small-scale low-cost loans for individuals and organisations in deprived communities has become well established. Specialised community banking service models have developed across the world and are evolving daily: the microfinance market has seen the emergence of innovative and groundbreaking models for secondary debt market development, as well as public/private/philanthropic partnerships for investment.

One of the most sophisticated new debt developments is the AAA-rated bond issued by the Wellcome Trust in July 2006 to raise funds for health and biomedical investments. This was an innovation for a charitable trust, and the first bond of its kind to attract star rating, although Industrial and Provident Societies have a considerable history of issuing shares, bonds and loan stock. Golden Lane Housing, an IPS, was the first social enterprise to issue a bond (see *demandside*, above).

COMMUNITY DEVELOPMENT FINANCE INSTITUTIONS (CDFIs)

CDFIs are small, sustainable, independent financial institutions providing finance and support to individuals and enterprises, particularly in disadvantaged communities and under-served markets. There are now over 500 CDFIs in the USA, consisting of banks, credit unions, loan funds, venture capital funds and micro-enterprise loan funds. CDFIs in the US, partly as a result of involvement in financing affordable housing in the 1980s, became heavily involved with the banks and began to access considerable private finance. US research, however, reported few CDFIs positioned to do equity investing, and the industry segmented into a small number of 'star' institutions that are able to attract private equity investment

for community development venture funds, and a large number which struggle to remain competitive against mainstream lenders in the small-scale and under-served sections of the finance market (Moy and Okagaki, 2001).

Although US CDFIs have had some success with secondary market transactions, volumes are small. One of their most important roles is mediating private finance to support community projects, through loan packaging, loan brokering or sale of loan participations to mainstream institutions and investors that lack the capacity to fund or underwrite community investment themselves. One reason for the difficulty experienced by CDFIs in accessing finance markets is high transaction costs due to lack of standardisation in their product offering. This might be addressed by streamlining their work through standardisation of loan documents and due diligence procedures; introducing standards for loan servicers in order to protect long-term asset quality; by getting licensing and certification procedures for institutions and individuals accepted in the mainstream financial community (and not just the CDFI industry); and more collaboration between organisations to facilitate timely and efficient aggregation of loans.

For CDFIs the problem with standardisation is that it flies in the face of the service customisation and autonomy that are their hallmarks. In the UK a further problem is whether there is a large enough market to support standardisation, particularly if CDFIs face increasing competition from the mainstream banks. Without it, they may find it difficult to attract conventional investors, who usually cannot learn about or purchase CDFI financial instruments through conventional sales and information channels.

A good potential model for a UK community investment fund to help attract further finance is the US Calvert Community Investment Notes (see Emerson, Freundlich and Fruchterman, 2007). Investors buy a note for a set length of time, after which they are paid back the principal plus a fixed rate of interest. The finance raised is loaned exclusively to organisations creating social change. Community Investment Notes are designed to pay a fixed below-market rate of interest, determined at the time the investment is made, for the term of the note. By spreading its investment across a broad range of programmes the Calvert scheme

lowers the investors' risk of losing money even if one of the programmes goes under.

Capitalised by government, charitable funds and some commercial finance, community finance intermediary institutions have become a cornerstone of the social investment infrastructure in the UK. The Social Investment Task Force (2001) recommended that CDFIs should be supported and become eligible to attract investment under the community investment tax relief scheme (CITR), which was introduced by the UK government to provide an income tax relief for investors in enterprise in deprived areas. Figures for their current scale are provided by the Community Development Finance Association (CDFA, 2005), the industry body, which reported more than 60 members responding to its 2005 survey, with a presence in all regions and a total loan portfolio of £181m. The 2005 survey also reported increasing business in the micro-enterprise (served by 50% of CDFIs) and start-up markets.

There is a range of other social enterprise lenders, both specialised and mainstream, including Charity Bank (which recently opened its first regional branch in the North of England), Triodos Bank, Unity Trust Bank, the London Rebuilding Society, BigInvest and the government's Futurebuilders and Adventure Capital Funds. Charity Bank and the London Rebuilding Society offer a form of equity investment, in the sense of having a financial base with shareholders. The success of these community banking models has prompted mainstream providers to enter the market for small-scale local finance, and the DTI *Small Business Survey* (2006) showed an increase in the proportion of social enterprises accessing commercial finance to 66% (although this is still below the rate for small and medium-sized enterprises at around 80%). Mainstream banks may provide harsh competition for community finance providers for the top end of the small loan market, which could jeopardise their financial viability in the longer term.

Another challenge for CDFIs is their dependence on government subsidy, receiving up to 58% of their income from the Phoenix Fund and other trust funds. Further capitalisation also presents a challenge. The CDFA reports that over one-fifth of the income from finance raised by CDFIs in 2005 was provided by the banks, and that developing access to finance and investment strategies are

key priorities for the more mature CDFIs, while acknowledging that both young and mature are likely to continue to require grant capital.

CREDIT UNIONS (CUs)

Although credit unions are not new, their role in the social investment landscape has expanded over the last decade. There are now almost 800 CUs in the UK, with assets worth £900m. Many have focused on low-income communities, which has made growth more challenging; some larger ones have been able to extend their common bond activities to increase their membership and asset size. Like the CDFIs, they are characterised by huge variations in scale and face similar challenges in accessing finance and achieving sustainability.

SOCIAL INVESTMENT FUNDS AND QUASI-EQUITY

Bridges Community Ventures represents a new model of a venture investment fund taking quasi-equity positions in high-potential businesses in deprived areas of the UK (Howard and Giddens, 2004). This has proved to be very successful and a second fund is under development. Looking at US experience of quasi-equity investments, the Columbia Business School RISE report (2003) estimated that there were at least 59 social venture capital funds in the USA with over \$2.6bn under management and over \$1.9bn of total finance available for investing in what are described as 'Double Bottom Line (DBL) Entrepreneurial Ventures' that strive to achieve measurable social and financial outcomes. Examples of social investment funds in the USA include: the Investors' Circle network of business angel investors funding companies they view as socially responsible – its investments made returns of 5-14% (Carden and Darragh, 2004); Generation Investment Management, an employee-owned partnership that invests for the long term in carefully selected stocks in 30-50 companies working in a pre-defined range of social issues; and the Rockefeller's Provenex Fund provides critical venture capital to health-related companies developing products and treatments with great potential for social benefit.

There are some private social venture capital companies in the UK developing alternative socially oriented approaches to investment. Foursome is family owned and believes ownership is important to enterprise success. It takes a flexible approach

to the balance between social and economic return, with an 'aspirational' financial return of 30% on investment. Other UK companies include Catalyst, a venture fund specialising in social innovation, and P3, which advises investors on high-growth entrepreneurial companies with social purposes. BigInvest offers a range of products at different levels of return. Overall, in the UK, the social investment market – as distinct from generic SRI funds – is worth significantly less than 1% of the total capital under management.

These examples illustrate different investment approaches to providing sources of growth finance through balancing higher risk, lower return, and social value in a way acceptable to certain types of investor. Such approaches can diversify risks for social investors and maximise blended returns across a portfolio mixing high social/low economic return and high return/low social return investments. In many ways social investment funds offer the most obvious bridge between social investment and mainstream capital markets.

Microfinance is leading the way in secondary market development, at national and global levels (for full treatment of this topic see Emerson, 2006). For example, the Antares Fund, founded by Grey Ghost Fund, a private equity investment firm, recently purchased a 4.5% equity stake in Findesa, a microfinance fund in Nicaragua, and now has investments in three other microfinance funds. Blue Orchard, based in Switzerland, is an investment broker for microfinance, and Acumen uses charitable grants from the North to lever mainstream finance into emerging economies.

EQUITY

As has been noted, there appears to be a large potential market for ethical investments in share ownership and there is a developing market for such investments in social enterprise. However, growth to date is slow and remains constrained by:

- Limited investment opportunities
- Limited returns
- The lack of an established stock exchange market
- The lack of liquidity in available swaps markets
- Ownership restrictions to protect mission

- Limited performance information

- Price-setting anomalies

(See the discussion of a social investment stock market above.)

SUMMARY: SUPPLYSIDE

- Investment is still largely sourced from philanthropic and public funds, and varies in the extent to which it seeks a market return.

- Private sector involvement is mainly confined to:

- debt and quasi-equity finance for social organisations at the lowest-risk, largest and most profit-oriented end of the spectrum.

- private finance manager involvement in disbursement of charitable funds.

- The market for low-risk, small-scale, debt financing has become well established in the private, public and third sectors and shows signs of over-supply.

- A very small amount of specialised growth funding in the form of quasi-equity, patient finance, or venture capital investment is available and sourced from the public and third sectors. This accounts for less than 1% of the income of the third sector.

- A very small number of social enterprises are beginning to deal in bonds and share issues. However, limited liquidity, ownership restrictions, lack of performance data, and no developed stock exchange marketplace are constraining the development of secondary markets.

- The number of specialised finance intermediaries such as CDFIs and Credit Unions has grown, and has widened access to loan funds, but these organisations themselves have yet to reach scale.

THE NEW INSTITUTIONS OF SOCIAL INVESTMENT

Having set out the current landscape of social finance and its main actors, this report will conclude its analysis by considering which trajectories can move the social investment marketplace out of the margins and into the mainstream. It has already been noted that simply applying existing finance models to social or environmental projects has had limited impact in terms of growing both the supply and demand side markets. Conventional finance institutions appear ill-equipped to act as the catalytic intermediaries in this space and the power relationships inherent in this monological approach create disincentives on the supply side to engage.

An important issue here is that conventional notions of risk need to be extended beyond simple calculations concerning how likely it is that a financial investment will fail. In the social investment space two further types of risk are relevant, both on the demand side. First, reputational risk is an important consideration since much of a social enterprise's right to operate

rests on its perceived legitimacy in the eyes of its key stakeholders. Taking any investment capital itself may be seen as potentially jeopardising institutional reputation and trust, perhaps being portrayed as 'selling out' or privatising social or environmental action. Even if such action can be justified, the choice of investment partner is likely to come under serious scrutiny and there remain significant challenges to the institutional logic of many social purpose organisations (founded as it is on notions of public benefit) in engaging with conventional capital market structures. These include ownership issues and an aversion to supporting speculation.

Second, demand side actors in the third sector are often perceived to be largely defined by their independence from the other two sectors. Partnering with capital from the private (or public) sectors could be seen as compromising this independence. Central to this are the power dynamics of capital investment. The legal and transactional mechanisms that frame

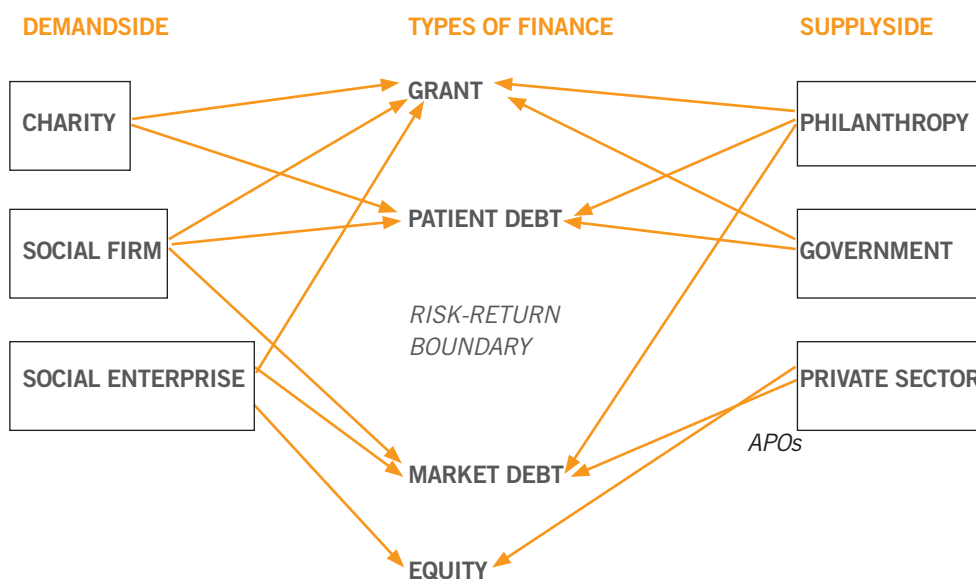
such investments can alter the control of the organisation's strategic agenda and generate mission drift. Even the potential threat of this can be enough to dissuade social purpose organisations from seeking outside funding – hence the reliance on personal credit cards for start-up finance noted above. Therefore, another important research strand will be to explore what can be learnt from contract economics and law structure investment deals that counter the inherent risk-aversion of the social enterprise sector towards external investment. A logical conclusion of these issues is that a new set of institutions needs to be evolved to develop the true potential of social investment going forward.

The emerging social investment landscape can be sketched out in terms of the connections between supply and demand organised according to type of finance (see Figure 6). Central to this model is the notion of a risk-return boundary. This line separates what are conventionally seen as market-rate (or above) investment opportunities from those considered sub-market rate. Below this boundary are debt and equity investments for which an adequate financial return on perceived risk is expected; above the line the level of risk (100% in the case of grants) exceeds the expected

financial return and, consequently, requires some form of subsidy to engage conventional finance. The private sector sits on one side (as investors) and charities sit on the other (as investees). However, what is interesting to note is that the other supplyside and demandside institutions in the model are increasingly moving across the conventional risk-return boundary towards more blended investment approaches that reconfigure risk and return as more than just a financial return on investment calculation. For example, on the supplyside, government investments may support charities (via tax subsidy), social firms (via grants) and social enterprises (via debt) to – in effect – diversify the risk of its investments in terms of creating efficiencies in the delivery of public goods. Conversely, on the demandside, social enterprises may access finance via a mixed income model that includes grants, patient debt, market debt and (quasi) equity. Quasi-equity, via APO equity investments, provides the strongest current link between the private sector and social enterprises, as noted above.

Two important factors are emerging to change perceptions of risk and return in the social investment landscape. First, when contextualised in terms of blended value

FIGURE 6: SOCIAL INVESTMENT RELATIONSHIPS BY TYPE OF FINANCE



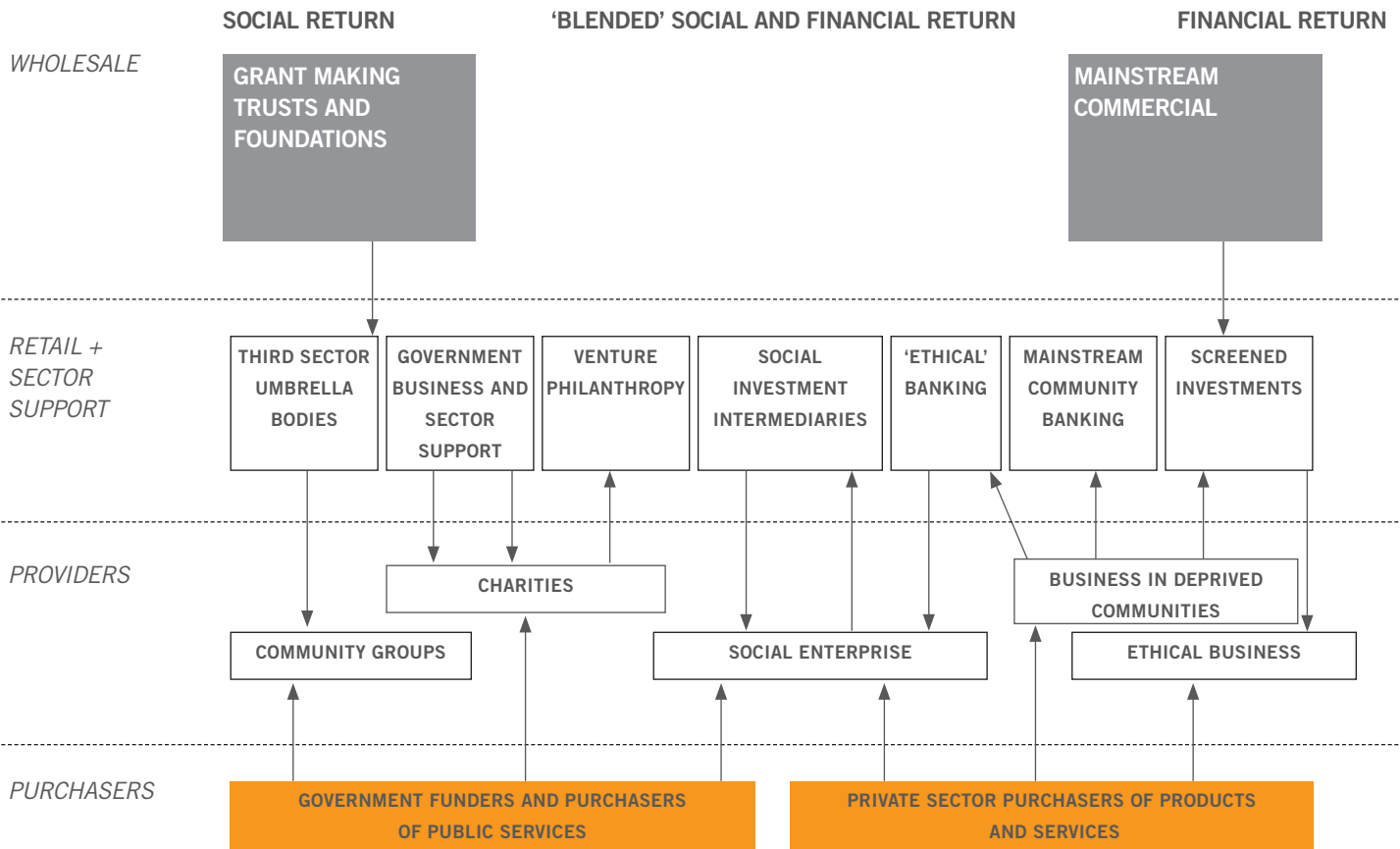
investing, the conventional risk and return relationship is altered. In the same way that the discounted net present value of the expected return is incorporated into a conventional return on investment calculation, so future social impact can also be given a net present value. What such a calculation can show is that to invest now may have significantly more social impact than would be the case if investing were delayed until later. For example, in the case of education and health, there is strong empirical evidence that positive interventions early in life can have far greater impact than those delayed until later. Similarly, in the case of natural disasters or famine, it is obvious that immediate action creates far more social impact than later support. The same is also true of environmental interventions to address climate change. However, this is not to say that all social or environmental value is best created

‘up front’ – other action needs continuous support over many years (for example on the environment) – but what is clear is that risk and return calculations around social value have a temporal dimension that needs to be better understood by social investment investors.

Second, as suggested in Figure 6, risk can increasingly be diversified across a social investment portfolio that allows financial and social value creation to be maximised according to investor preference. As a result, institutional investors may be able to buy structured products that function like fixed-income instruments and that combine sub- and above-market rate returns with high social and environmental impact. An important area for future research will be how to build a range of instruments structured so as to meet a variety of return-on-capital requirements whilst also maximising social returns.

Another way of conceptualising the players in the new landscape of social investment is in terms

FIGURE 7: LANDSCAPE OF SOCIAL FINANCE BY CONTRACTUAL ARRANGEMENTS (ADAPTED FROM GREGORY, 2007)



both of existing providers of start-up, growth, or working capital (wholesalers) and purchasers in the market for goods and services in which social purpose organisations compete (see Figure 7).⁹ The wholesalers can currently be divided into those seeking full market-rate financial return and those seeking full social return. Social purpose organisations can be conceptualised as providers of goods and services with a support sector (effectively the intermediaries discussed above) channelling these sources of wholesale finance towards them. This model is consistent with Figure 6 in its presentation of social investment wholesalers as aggregators of capital from a range of risk-return sources (including grants, ‘recycled’ finance from social purpose players such as Charity Bank, and market-rate investors). However, what this model most clearly suggests is the current gap in the landscape for a new ‘blended value’ group of capital wholesalers that can draw on a mix of market-rate and not-market rate sources of capital to fulfil the complex financial needs of social enterprises. The Commission on Unclaimed Assets may provide one solution to such a gap under its proposals for a Social Investment Bank, but private and third sector players could also work more closely together to address this challenge and configure new investment opportunities (see further below).

As a consequence, despite these developments in conceptualising the risk-return dynamic, it is clear that in order to populate the landscape of social investment to maximise the depth and breadth of investments a new institutional structure will be required that encourages a portfolio approach across the conventional risk-return boundary. All three sectors within society can play a role in achieving this change.

GOVERNMENT

Government is playing an important role in shaping the institutions of social investment – and their relationships – with both regulation and financial support. The introduction of CICs demonstrated that policy makers are prepared to use legislation to support the development of social enterprise. However, further opportunities for government action remain. Of particular importance would be supporting the development of new accounting and

reporting regulations that could recognise social value creation as part of organisational performance. Government could also introduce stronger measures to grow the opportunities for public sector contracts amongst social purpose organisations.

One idea which has been put forward is the creation of a Social Investment Bank (SIB), dedicated to wholesale social investment and to building the social investment infrastructure (see Commission on Unclaimed Assets, 2006).¹⁰ A SIB could, for example, be used to underwrite finance flowing across the risk-return boundary by bridging the gap between market-rate returns and the actual returns of some social enterprises. This could be underpinned by new tax relief mechanisms for social investment developing further the principle of CITRA.

Finally, building on the success of Bridges Community Ventures, a model for using public money to support the development of new, dedicated equity-like funds for social ventures with a risk-spreading approach to return could be explored.

PRIVATE SECTOR

The private sector has an opportunity to exploit the full potential of a range of emerging ethical markets across the entire value chain (Nicholls, 2007). For example, fair trade has huge potential to demonstrate the synergies between traditional enterprise motivation and social concern within a climate of growing demand for ethical consumption.

Furthermore, as the private sector comes better to understand the values and benefits of social purpose organisations, new partnerships could evolve that share learning, skills and resources to mutual benefit. This could go beyond mere PR or ‘greenwashing’ to create new hybrids. More commercial companies could sub-contract parts of their supply and delivery chain to the not-for-profit sector to increase efficiency and market reach. The current fashion for ‘Bottom of the Pyramid’ models (Prahalad, 2006) demonstrates how social entrepreneurship can offer corporations market access to the poor. Whilst such models can be dangerously self-serving and very limited in terms of meaningful social benefit, they do indicate new sets of opportunities for the private sector to engage with the social.

The emergent social investment landscape needs a significant increase in liquidity if it is to

⁹ My thanks go to the Office of the Third Sector for some of the insights behind this model.

¹⁰ It is estimated that there is up to £400m in unclaimed assets currently available and that a Social Investment Bank could ultimately distribute up to £2bn (Mathiason, 2007).

¹¹ Big Issue Invest is a specialised provider of finance to social enterprises, led by social entrepreneurs and staffed by mission-driven financiers from the World Bank, ShoreBank and private retail and investment banking. Financial structures offered include asset and cash flow-backed senior debt, as well as cocktail financing that may include royalties, loan conversion and guarantees. Each loan is tailored to each enterprise's stage of development and risk profile, as well as being focused on scale-up. Capitalised by the government's Phoenix Fund and Bank of Scotland investment through the Community Investment Tax Relief (CITR) scheme, Big Issue Invest has seen a healthy pipeline for £4.5m of loans since its inception in November 2005, and has another £1.5m of CITR funding coming on stream. It recently launched two innovative projects: a low-cost, flexible vehicle that will allow social enterprises to access contract financing to deliver public service contracts from public sector bodies, and an alternative Credit Ratings Index focused on increasing access to regulated, affordable credit among low-income people. Its experience is that there is also a need for a greater diversity of funding, particularly for start-ups, new CICs, and fair trade and social enterprises that do not fit CITR criteria. Source: personal communication with Puchka Sahay Direnzo, fund consultant, Big Issue Invest, December 2007.

bring in more conventional investors, including large institutions such as pension funds. If the private sector can grasp the new market opportunities available in social investment then it can play a vital role in bridging the current liquidity gap. This would also include playing a more active role in the development of a secondary market in social investment for successful and growing profit-making social businesses. Examples already exist, such as Triodos Bank, which launched its first UK share issue in April 2007 to raise £4m to finance social, environmental and community projects. The challenge is for private sector financial institutions to move out of models of wealth management that view social investing as philanthropy towards more creative hybrids that span the risk-return boundary.

THIRD SECTOR

Whilst it has been noted above that both government and the private sector have been cautious in making available significant investment capital for social purpose organisations, the same can also be said of large parts of the third sector. Whilst there are examples of creativity and innovation in investment strategies – for example, Big Issue Invest¹¹ (an offshoot of *The Big Issue*) has an investment fund for commercial businesses that want to become more socially entrepreneurial – many organisations in the third sector show little or no sophistication or risk-taking in terms of financial strategy. Clearly, social entrepreneurs are critical here.

The extent to which social enterprise is held back by the non-profit-distributing nature of many of its income-earning enterprises needs to be researched further. Mission drift is a problem if successful social enterprises compromise their social objectives to satisfy investors, but it is also the case that not-for-profits have a long history of successful trading to fund their work. Community enterprise around the world has shown how powerful the acquisition of local property assets can be for attracting investment and growing local social enterprise. Social

purpose organisations need to recalibrate their own risk and return perceptions according to the emergent social investment landscape, carefully balancing opportunities for new resources against the drive towards ever-greater mission impact.

There are important issues here around language and differentiation. Would certain segments of the social investment space have more opportunity to grow if they defined themselves as a for-profit social purpose sub-sector and demarcated their space within the big tent of social enterprise? Could this be where a new social investment asset class begins? Jones and Keogh (2006) have commented on the anxiety over the issue of profit in the definition, and whether social enterprises are for-profit or not-for-profit. Underlying such comments is ongoing uncertainty about whether social enterprise is an organisational form or type of output – an issue likely to become more significant as different sectors get involved. As has been noted above, it seems likely that the social investment marketplace would develop faster if there were distinct differentiations between the different kinds of organisation within it and their finance needs.

In addition to greater clarity about risk and return within the sector there also needs to be much more inter-organisational sharing of data and strategic innovation. In the current absence of market mechanisms to disseminate best practice and reward success, social entrepreneurs could play an active role in co-ordinating and spreading innovation and learning across the sector. Organisations might achieve common aims more effectively if they moved out of their silos and worked together. New partnerships and, even, mergers where scale could improve impact and access to finance, might be developed if there were more co-operation. A very practical step forward might be for social entrepreneurs to work together within sectors towards developing pooled investment products that reduce risk for the intermediary market to sell on.

CONCLUSIONS

This analysis presents the current landscape of social investment framed principally by demand, intermediation and supply. Whilst acknowledging that the use of conventional models of financial markets limits the discussion of social investment in all its diverse forms, it has drawn on this framework as a starting-point for analysing and appraising current developments. Like mainstream financial markets, the landscape of social investment is highly differentiated, from those needing grants, loans or quasi-equity either for start-up or expansion (possibly on discounted or preferential terms) to those who believe that they need access to the mainstream financial markets to reach potential scale. This paper has suggested that a more holistic account of social investment is required that includes a range of funding from grants to full-market rate return investments and that only with this diversity of resource can the entire spectrum of social purpose organisations be supported and developed.

This research suggests that social investment is still an emergent field, an innovative space that is attracting new and varying types of investment from different public, private and third sector actors with a common desire to generate greater and more effective social and economic returns. At this stage in its development social investment means different things to different people: money used for specific social purposes; investment bringing blended value returns; a special class of financial products; finance for special types of organisation and activities such as social enterprise; a form of ownership and so on. These varying perspectives are related to different assessments of the current state of supply and demand and to different expectations of what social investment can deliver.

The social investment marketplace is characterised by risk aversion, uncertainty and fragmentation. While the analysis presented here points to significant gaps and opportunities in the social investment market, it also indicates that

addressing the development of social investment for innovative social projects and organisations is likely to mean challenging some of the traditional boundaries between the public, private and third sector approaches to investment in order to build the new institutions of social investment.

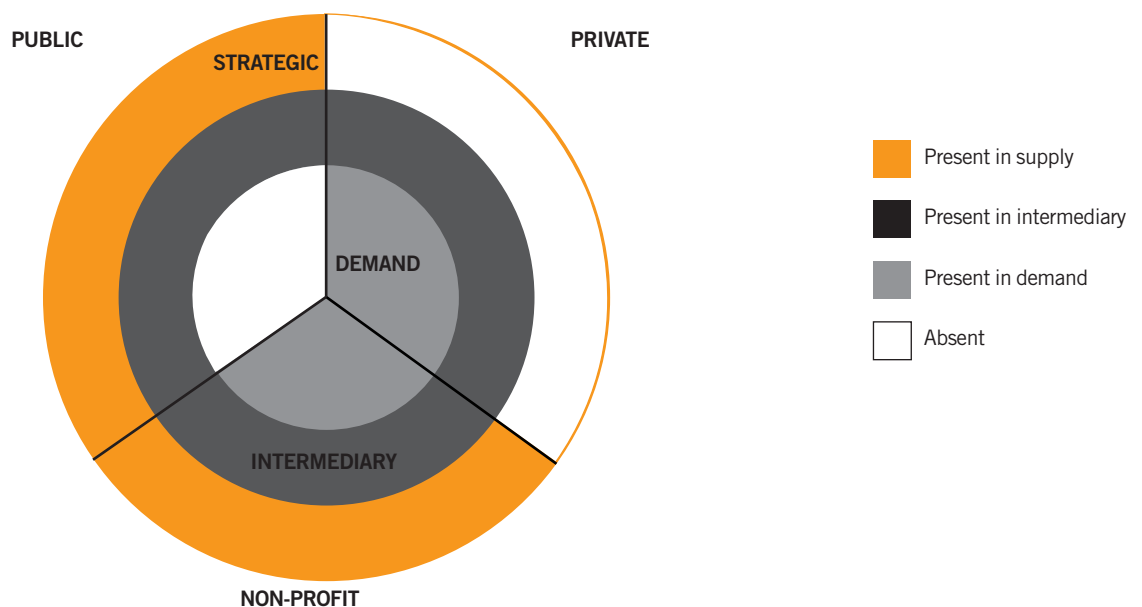
The fragmentation of interests in the social investment marketplace is leading to a disjointed structure. Although all three sectors participate, they are present in different sections of the marketplace, as Figure 8 shows. This fragmentation reflects the main actors' different starting-points. Referring back to Figure 1, which set out drivers towards social investment: government interest in creating a supply of finance for social enterprise was driven by policy imperatives arising from the needs for social and economic regeneration and greater responsiveness and efficiency in welfare provision; the third sector was driven by failures in the existing supply of finance and new opportunities; and the private sector has been driven to find new types of investment market through new strategic imperatives around corporate social responsibility, public/private finance initiatives and through the rise of ethical consumerism (Nicholls, 2007). The current structure of the social investment landscape is sub-

optimal. On the one hand, it lacks the coherence of the conventional market mechanisms that have helped financial services move from single deal to aggregate deal structures, generating a supply of cost-effective and appropriate investment finance. On the other, it has not been acknowledged as requiring permanent and substantial public subsidy in the same sense as other public goods markets such as social housing and health. While the combination of public, private and social sectors has led to innovation and opportunity in the social investment space, it is also currently a source of some tension and constraint

This has led to unmet need in areas such as start-ups, unsecured lending, higher-risk growth finance and market mechanisms for the wholesale supply of finance for intermediary finance suppliers. It has also meant low demand for the loan finance available from social and mainstream providers, as well as the high-cost growth finance that would be available commercially.

As has already been noted – with some serious caveats concerning both demand-side investment readiness and supply-side suitability of finance – it seems that gaps in intermediation currently represent the main barrier to accelerated growth. An analysis of the intermediary landscape suggests

FIGURE 8: DISTRIBUTION OF TYPES OF ACTOR IN SOCIAL INVESTMENT



three main factors that are holding back sustained, and more rapid, growth of the range and depth of social investment available to social purpose organisations. These are: poor segmentation of social investment opportunities; a dearth of rigorous and relevant performance information within such segments; and insufficient attention being paid to developing and educating the social investor market.

SEGMENTING INVESTMENT OPPORTUNITIES

At the moment, the social investment landscape lacks clarity and consensus in relation to the goals, expectations and measurable outcomes of social purpose organisations, and has many of the characteristics of a fluid social movement of interests rather than a marketplace. This means that it may be both inappropriate and unhelpful at this stage simply to apply conventional notions of the role of finance and commercial markets to assessing the state of social investment. It also means, by implication, that this model may not be appropriate for diagnosing what needs to be done to increase the range and volume of finance available to social purpose organisations.

A first step towards the development of a more effective approach would be a better analysis, or codification, of the complex causal paths that can optimise the relationships between blended value creation opportunities and financial support within social investment. A closer analysis of the varying drivers and value systems behind different types of social purpose organisation is, therefore, needed. Similarly, attention should be paid to the varying balance of interests between key actors who have some ownership stake in the organisation and their relationships to its possible financial structures, these include: the social entrepreneurs, their staff, donors, government, other investors, beneficiaries, etc. For example, lessons could possibly be learned from more applied comparisons with the early financial structures of small and start-up businesses, and the role of personal investment, grants, external investments and so on. Recent research has shown that participants in the UK New Entrepreneur Scholarships programme make significantly lower start-up investment than is typical in small businesses, particularly in terms of personal finance, and that this undercapitalisation needs to be addressed through a range of policy measures (Rouse and Jayawarna, 2006). Other

research has shown that access to family and close associate networks and formal and informal finance play a strong role in growing enterprise in both ethnic minority and other small-scale owner/manager businesses (Hussain and Matlay, 2007). To date, there has been little study of the role of self-funding in social purpose organisations.

In order to facilitate new capital flows, the social investment spectrum needs to be carefully segmented for investors not only according to sector and organisational size, but also according to investee value systems, resource requirements, risk and return characteristics, optimum duration of investment, and exit options. Critical to this analysis will be new risk-return measures (see above). Individual organisations should be identified by the type of funding best suited to maximise their mission objectives, rather than by particular investor preferences. These funding opportunities could be bundled together as an investment product. In turn these could be blended across a portfolio to achieve the levels of social and financial return required by investors, depending on their personal objectives.

INFORMATION PROVISION

The current state of market information about what social investment can offer in relation to social and economic returns is very poor. Investors have fragmented and non-comparable data with which to make investment decisions and there is a dearth of well-documented social and environmental value creation information. This report has suggested a number of practical ways forward to improve information asymmetries between supplyside and demandside, including:

- Developing a clear social investment index, listing or social stock exchange to indicate the status and performance of a social enterprise.
- Incentivising new players to enter the intermediary space within social investment from both conventional finance and the third sector. This will almost certainly need government subsidy and support.
- Refining existing performance metrics for social purpose organisations to include new frameworks that bring together established qualitative and quantitative mechanisms with bespoke reporting.

- Building transparent data sets of performance by organisational type and sector.

- Developing new investment products, such as have been demonstrated by the successful securitisation of bundles of microfinance loans as mainstream debt products.

However, better and more plentiful information alone will not make the social investment market expand. There remains the key question of which data is best suited to drive the impacts of social investment to new heights: to make sense to investors and intermediaries without compromising the needs of social purpose organisations. A close examination of the development of today's conventions in financial accounting, reporting and markets over the past one hundred years suggests that a combination of structural interventions from government via regulation and market mechanisms that encouraged a multiplicity of models and then winnowed out the least efficient drove innovation forward towards consensus (see, for example, sociological analyses of the history of accounting in Hopwood and Miller, 1994). This process reduced perceptions of risk and facilitated a rapid expansion of available capital. The lesson for social investment must be that there is real value in developing a wide range of (competing) measurement and reporting systems and then allowing the investment market to differentiate between them in terms of utility, given that social entrepreneurs must be active players in framing the expectations of such a market. There is also a role for government to intervene further to reduce investor risk through regulation and monitoring of the new intermediary institutions of social investment as they emerge.

It must also be recognised that there will be multiple perspectives on performance and that, in the absence of established contractual conventions protecting the interests of both social investment parties, the power relationships inherent in this landscape need to be delineated and accounted for in an emerging performance measurement research agenda. Therefore, the key question of what the priorities are for better investment information must be framed by additionally asking whose priorities and to what ends.

DEVELOPING THE INVESTOR MARKET

Although considerable resources have been devoted to models for performance assessment and social return, very little is known about the motivations and expectations of social investors. How much value do they actually place on social or economic returns, and how does this affect their support? In an era of increasing ethical consumerism and investment, the willingness of ethical investors to enter the social investment market should be assessed more carefully. More market research is needed in order to understand better the supplyside structure, opportunities and incentives for social investment.

Moreover, by delineating the spectrum of social investment opportunities more clearly, supported by better information provision, the investor market can be segmented and targeted more effectively. This will allow different investors to be presented with different opportunities across the spectrum that fit with their investment needs – from philanthropy to full-market return – and will dramatically improve the allocative efficiency of social investment intermediaries and lower transaction costs. Such action will build bridges between conventional capital and social entrepreneurship.

The role of social investment intermediaries is again crucial here – this time as market makers to ‘place’ investment in blended value opportunities and help develop a wider pool of investors. Changes at broader societal level are pushing in this direction as consumers increasingly value their purchases across a range of dimensions, both functional and emotional. The expansion of SRIs and the emergence of funds such as that developed by Generation Investment Management also indicate that there is a substantial segment of capital that could be targeted for expanding the flow of social investment. Indeed, there is a strong first mover advantage in addressing this emergent demand.

However, poor investment segmentation coupled with poor performance information result in an investor perception of the social investment market as being high risk. Such perceptions of risk, which are not adequately accounted for in terms of conventional return, represent one of the main barriers to the development of social

investment. Specifically, social investment is fundamentally interpreted as a deficit/subsidy model that supports otherwise unviable organisations, rather than one generating positive blended value. This perspective sees social investments as trapped in a mission-driven, economic 'double bind' that combines the production of outputs into unprofitable markets (ie social care) via unprofitable operational processes (ie employing high-cost workers such as ex-offenders).

Consequently, an important strategy for developing the investor market will be to reduce perceptions of risk by better articulation of the special qualities of social purpose organisations based around their levels of sociality, innovation and market-orientation. In addition, social purpose organisations should be encouraged to develop mixed income strategies that blend grants, debt and other forms of funding to both reduce their own exposure to one type of funding and to reduce perceptions of risk for the providers of each type of funding. This approach will also mitigate the risk-averse tendency towards external investment which equates outside finance with loss of control. By building the financial literacy of the demandside new opportunities for investment will emerge automatically.

In conclusion, the landscape of social investment has developed enormously in the last twenty years, but it is still some way off providing the flow of resources needed by social purpose organisations to fulfil their potential for social and environmental change. On the suppside, the full range of investment opportunities has also to be realised. The key challenge will be to reconcile the very different demands and expectations of the actors within this space via a new set of shared perspectives that can effectively articulate the opportunities and challenges of social investment. Part of this project will be to redefine the conventional risk-return relationship for investment, integrating values as well as valuation into the functions of a social investment marketplace. This requires new narratives of social investment to be developed and tested by qualitative research, alongside richer and more comparable quantitative performance data.

To achieve this outcome this research suggests that key players across all three sectors will need to collaborate to create both new institutions and new institutional arrangements. To begin with this project may tend to reflect the conventional landscape of capital markets and philanthropic activities, but, if successful, it could in time establish both an entirely new blended value discourse and practical mechanisms for social purpose organisations to accelerate their impact unfettered by the isomorphic performance conventions of traditional financial systems.¹²

¹² See DiMaggio and Powell (1983) for a discussion of isomorphism – the tendency for organisations to adopt similar forms and patterns of action under coercive, mimetic or normative pressures from the wider institutional landscape.

KEY CONCLUSIONS

DEMANDSIDE ACTORS NEED:

- Better segmentation of investment opportunities
- New financial instruments that fit with multiple social and economic objectives, as well as qualities such as innovation, inclusion, growth potential and sustainable social change
- Increased performance transparency and information
- Exchange incentives such as underwriting or guarantees from third parties

INTERMEDIARIES NEED:

- More regular, public, reporting on performance and impact
- Less fragmented investment landscape
- Critical mass of investors
- Greater liquidity
- Standardisation in the language/terms used to refer to social purpose organisations

SUPPLYSIDE ACTORS NEED:

- Greater financial literacy
- Financial options across all stages of the organisational lifecycle
- Legal contractual mechanisms to protect against mission drift and take-over
- Incentives to diversify funding and income base

IN SUMMARY, TO FLOURISH, THE SOCIAL INVESTMENT MARKETPLACE NEEDS IMPROVED:

- Standards and regulations, including more comparable quantitative information
- Deal flow, structured across a range of risk and return scenarios, as well as growth stages
- Transactional mechanisms, such as secondary markets, trading platforms and new intermediaries
- Narratives and 'brands', including rich qualitative data and ideal types

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