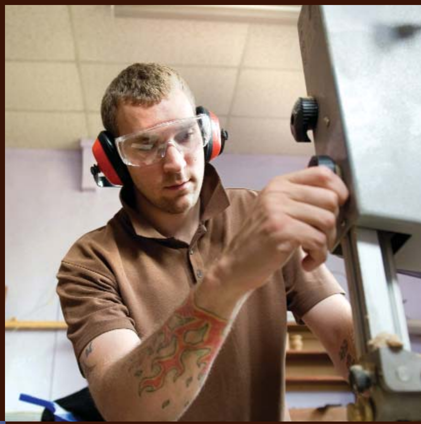
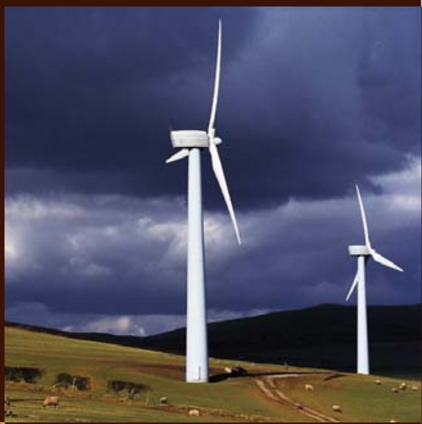
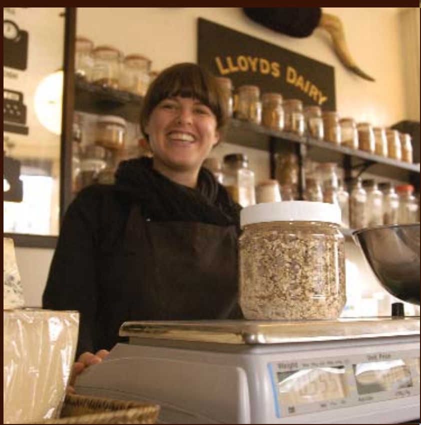
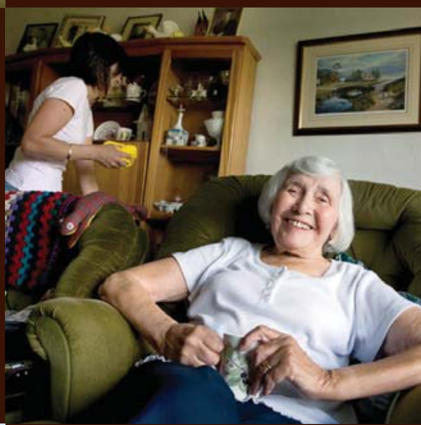
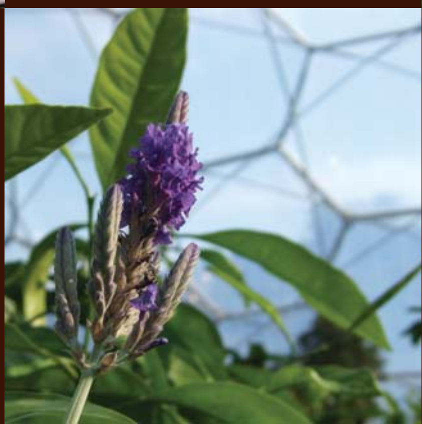








SOCIAL ENTERPRISE COALITION

# The Coutts Guide to Financing Social Enterprise

Coutts

# Foreword

Welcome to the second of our Guides to Social Enterprise, which focuses specifically on the issues and opportunities associated with providing finance to, and making investments in, the social enterprise sector. This guide has been produced in conjunction with the Social Enterprise Coalition, the UK's national body for social enterprise.

Since the launch of Coutts Social Enterprise Advisory Service in June 2010, we have seen increasing numbers of clients show an interest in the opportunities available to them in the social enterprise sector. Many are motivated to give back to society through supporting these businesses, including voicing an interest in learning about how they can support the sector financially.

Though they are incredibly diverse, social enterprises are the same when it comes to their core values: all are driven to make a positive change through business and entrepreneurship. They are not motivated solely by profit, but by sustainability and impact, and produce what is termed within the sector as a double or triple bottom line – a social and/or an environmental return along with a financial one.

Investing in a social enterprise provides an individual with the opportunity to make a financial return, similar to any other investment, but allowing the investor to benefit from a social or environmental return as well.

The non-financial returns are as diverse as the social enterprises themselves. These can be as varied as giving new opportunities to disadvantaged young people to creating innovative solutions to environmental problems and the regeneration of neighbourhoods and communities.

Social enterprises have the potential to make a large and lasting impact on the shape of the UK's economy, but access to finance remains one of their biggest challenges. This guide will set out the current landscape for social enterprise finance and the unique ways in which investors can connect part of their portfolios to worthwhile causes in a different way.

There is a social enterprise to suit the social interests of any individual and we hope that this guide will encourage you to look at financial opportunities that are borne from a passion to make a difference. If, after reading this, you are feeling inspired, please speak to the Coutts Philanthropy Team whose contact details can be found at the back of this guide or visit www.coutts.com/philanthropy

Michael J Morley.

Michael Morley
Chief Executive, Coutts & Co

# Measuring more than financial returns

Whatever else it might be, a social enterprise is still a business. What makes it unique is its focus on social and environmental goals. 62,000 such enterprises already exist and they contribute more than £24 billion to our economy every year. In the UK alone, they employ more than 800,000 people in every sector of industry.[1]

As the social enterprise sector grows, so too does interest from individuals wanting to support it through investment or the provision of financial support. Increasingly, individuals are recognising that social enterprises offer something different from investing in a traditional business or simply donating to charity in the traditional way.

Investing in a social enterprise is often based on a different set of criteria. For example, the decision to invest might be made on the basis of quite personal motivations, such as choosing to support a social enterprise that addresses a cause that the investor has a particular interest in. As such, financing a social enterprise is in many ways a more emotional investment for people – something they feel closer to than other aspects of their portfolios – even if it only makes up a very small proportion of it.

Individuals who invest in social enterprises do not just want a financial reward. Their aim is as equally philanthropic: they want to make a difference. But for investments in social enterprises to be linked to the organisation's social and/or environmental impact that impact must be measured and quantified to help investors assess performance along this broader spectrum.

Measuring social and environmental impact in this way is described as Social Impact Reporting (SIR). Measuring social value is still a pioneering field, and not unexpectedly, there is a fair amount of debate around it. While the goal of SIR is for any organisation to measure their social and environmental outcomes, the reality is that it can be time consuming and complex, particularly for small companies.

However, frameworks are being developed. These include the Account Ability Standard (AAS), the Global Reporting Initiative (GRI), Social Audit (SA) and Social Return on Investment (SROI). SROI specifically, is an approach to understanding and managing impact. It is based on placing a financial value on the impact an organisation may have that would not normally be accorded a market value. It creates a story to help understand the social and environmental value created by an organisation and demonstrates that narrative to its stakeholders.

[1] Department for Business, Enterprise and Regulatory Reform (BERR), 2007. Annual Survey of Small Businesses UK, 2005-2007. London: BERR

# What makes investing in social enterprises distinct?

For many social enterprises, raising finance and attracting investment is not straightforward. Because they operate as businesses, but are driven by social aims, regular forms of investment and financing are not always available to them. They face the challenge of balancing their social, environmental and economic aims, which means that financial returns to investors may differ to those of conventional businesses.

Finance drives all business development, including social enterprises; in fact, social enterprises are just as capital hungry as any other business. As the profile of social enterprise rises, so too does the demand for a strong, sustainable and socially responsible economy. That is why finance for this sector is turning in to a dynamic and exciting area, with new financial instruments being created to cater to its unique demands. The interested investor will have plenty of opportunities to get involved.

The development of innovative financial products provides investors with exciting new ways to engage with social enterprise. For example, they can address gaps between grants, donations and commercial finance. They can also enable investors to make their money work harder than it may have done as a traditional donation as returns could be recycled into further investment in social enterprises.

The legal structure or set up of a social enterprise is often designed to protect the business's social aims. Sometimes though, this can restrict it from accessing much needed finance. The most common legal form used in this sector is the Company Limited by Guarantee (CLG) – this prevents shares from being issued and equity being raised. Whilst investors can donate or lend money to an enterprise, they are unable to hold an overall stake in it.

The Community Interest Company (CIC) is a relatively new form of limited company set up specifically for social enterprises that encourages equity investment. The CIC model has a number of additional features that distinguish it from a standard company designed to protect the company's social aims. For example, the dividend payable on each share is limited to 20%. This helps to ensure a balance between the organisation's financial and social goals.

In addition to the challenges surrounding legal forms, many social enterprises are characterised by their social ownership, with governance and ownership structures based on stakeholder participation. Some have constitutions which limit the ability to borrow or raise equity. They may need board or shareholder approval to do this.

CASE STUDY 1

# Empowering communities in renewable energy

Alex Grayson is a principal of the Omni Group, a social enterprise at the forefront of making community energy a reality in the UK.

The Omni Group has been working in the finance and sustainability space since 2005. For the past two years, they have been setting up the Empower Community Fund (ECF), a scalable funding mechanism that will provide access to much-needed capital for community-owned renewable energy projects.

Alex says: "While grass-roots, action-oriented responses to climate change continue to grow exponentially, the current limited access to finance is hampering the wholesale development and implementation of distributed energy solutions at anything like the scale or speed required."

Omni has financed ECF from a combination of its own resources and investment from known social entrepreneurs. They found four individuals who believed in the fund and business plan. An agreement was then made to provide soft loans that would be converted in to a preference share in ECF once the vehicle was ready.

One such investor was Hamish Cormack, an energy surveyor by trade, who was looking for a different kind of investment. He was attracted to ECF by the vision and integrity of Alex and his partners, and his belief that the investment was a sound one.

Hamish says that while there is of course always risk with a start-up, he does not consider ECF especially risky, nor would he invest if he thought he would have to write it off. "I can't do charity on that scale, so yes, I do expect a return, as I expect ECF to do quite well."

But he says the non-financial returns are already coming in: "I'm getting exposed to a lot of interesting people and exciting ideas, and those are very fertile, worthwhile returns already."

On the opportunities of social investment, Alex says: "Investing in social enterprise is an exciting proposition for anyone interested in seeing what his or her money can do beyond just replicating itself. Community-level renewable energy can provide a more solid financial return to investors than many of the softer business models."

Hamish agrees: "I wanted my return to be more than a disembodied finance agreement, and this investment is already proving itself to be worthwhile."

"I'm getting exposed to a lot of interesting people and exciting ideas, and those are very fertile, worthwhile returns already." Hamish Cormack, energy surveyor

# How can investors connect with social enterprises?

There are many ways to invest in or finance social enterprises that can increase their financial returns and social and environmental impact. These options represent a significant opportunity for enlightened investors who want to add a unique (and perhaps more personal) element to their portfolios.

Social enterprises will vary in terms of their size, structure, scale and ambition. This means that their financial needs will often differ.

Some of the most common types of finance are outlined below:

**Venture philanthropy**
Venture philanthropy aims to apply the hands-on management techniques of venture capitalists to grant-making. These investors take a more active role in the organisation they are supporting, often by taking a seat on the board.

This form of financing aspires to improve the services provided by social enterprises. It achieves this by providing managerial support to enhance the capacity of the organisation in question.

For impartial advice to investors who want to give in this way, speak to the Coutts Philanthropy team who develop and share current information and best practice on giving and provide links to specialists. Their details can be found at the back of this guide.

**Loans**
Instead of donating a lump-sum to charity, individual investors are increasingly choosing to lend to social enterprises. By providing these businesses with much needed capital, they can help them to grow and develop. At the same time, they can 'recycle' the repayment of that loan and use it to help other notable causes. Whilst this system of lending is appealing because of its flexibility, there is still a risk. A social enterprise can default on its payments, just like any other business.

Social lending (often referred to as patient lending) refers to the practice of offering loans and other forms of finance below market rates to social enterprises that pursue social goals. The trend towards this form of finance has grown as reliance on grant income has reduced.

Loan finance is now the most common form of finance used by social enterprises. It gives these businesses more independence than grant funding and provides them with flexibility. Unlike equity, they do not involve ceding part-ownership. Social enterprises typically source their loans through mainstream commercial banks and social banks, such as Charity Bank and Triodos Bank. A number of high street banks, including The Royal Bank of Scotland, have in-house teams that deal with this sector.

Individuals interested in providing loan finance for social enterprises can also do so through the Coutts Social Enterprise Advisory Service. Contact the Coutts Philanthropy team for more information.

**Equity**
Most concepts of higher risk capital are structured around some form of equity. However, this has implications in terms of control and achieving social and environmental aims. Investors in social enterprises will want to see a return on their investment: not just monetarily, but in terms of a measurable impact on people and the planet. Social enterprises may also welcome the expertise that a hands-on equity investor can provide.

When it comes to raising finance through issuing equity, social enterprises, like any business, can do this in one of two ways: through investment by private individuals in return for part-ownership, or through public share issues. Social enterprises are generally looking for individual investors whose interests align with their own. Shares may be transferrable, which will allow investors to see their contributions grow. In some cases, companies will limit the ability of shareholders to make such transfers. To protect other participants in the scheme, directors may also reserve the right to block this type of transaction. To preserve their aspirations, social enterprises sometimes issue non-voting preferential shares or structure these dividends into various classes.

Initiatives to encourage investment in social enterprises are no longer unusual. For example, ClearlySo – a member on the Coutts Social Enterprise Advisory Panel – matches social enterprises with potential investors. This is achieved by running events that bring the parties together and through the provision of advisory services. Coutts hosts a number of events with ClearlySo. Your private banker can provide you with more details on these.

Some social enterprises have successfully raised equity through a public 'ethical' share issue. These shares are not traded on a stock exchange. Instead, they have the potential to be traded on a matched bargaining basis, where willing buyers are matched with willing sellers. An example of a social enterprise which has achieved this is Cafédirect, which raised £5 million in a share issue in 2004 with sponsorship from Triodos Bank. This kind of share issue is rare, but it could become a potential growth area for social enterprises in the future.

### Equity-like investment

Quasi-equity refers to financial instruments that are characteristic of both debt and equity. In these cases the return is dependent on performance and involves sharing the risk and reward between investors.

In the context of social investment, quasi-equity can refer to a number of instruments which combine the characteristics of grants as well as debt and equity. This can take a number of forms such as performance related grants, social loans or revenue participation agreements. These instruments allow investors to share in the proceeds of success whilst enabling the enterprise to retain and protect its social aims and on the whole these do not involve ceding ownership. For investors this means that any returns they receive are based on the success of a social enterprise.

### Donations

Many social enterprises have charitable status. Therefore, an investor or company wanting to make a donation to these organisations will be eligible for tax relief. As with traditional charities, as long as the individual is a UK taxpayer, the charity can recover the amount of the basic rate tax that the donor has paid on the amount of the gift.

CASE STUDY 2

# Providing patients with innovative care

It was Dr. Mohammad Al-Ubaydli's experience as a patient, not a doctor, that led him to innovate a new way for individuals to gain access to their medical records and share that information with clinicians of their choice.

"The fact that patients don't have easy access to their medical records is a time waster, a drain on resources and potentially dangerous", says Mohammad. So in 2008, he and a small group of co-founders set up Patients Know Best (PKB): a social enterprise that provides a secure website, now integrated into the NHS. It gives patients ownership of their medical records and allows them to consult with clinical teams when desired. Income is generated from care providers who save them money and benefit those in their care.

At the start-up phase, Mohammad and his partners self-funded PKB in order to maintain control of the business and prevent outside investors from controlling patient data. The first funding breakthrough came in the form of a £5,000 grant from UnLtd, which helped validate PKB's status as a social enterprise. This, in turn, led to a further grant from the East of England Development Agency.

Once they were in a position of some security, they were ready to look for angel investors to grow the business. It was then that things became more complicated. "We found that many were excessively timid," says Mohammad. "They would spend five months doing due diligence and even though they would find everything in perfect order, by the time they were ready to invest in us we had moved on, built the product and gained paying customers."

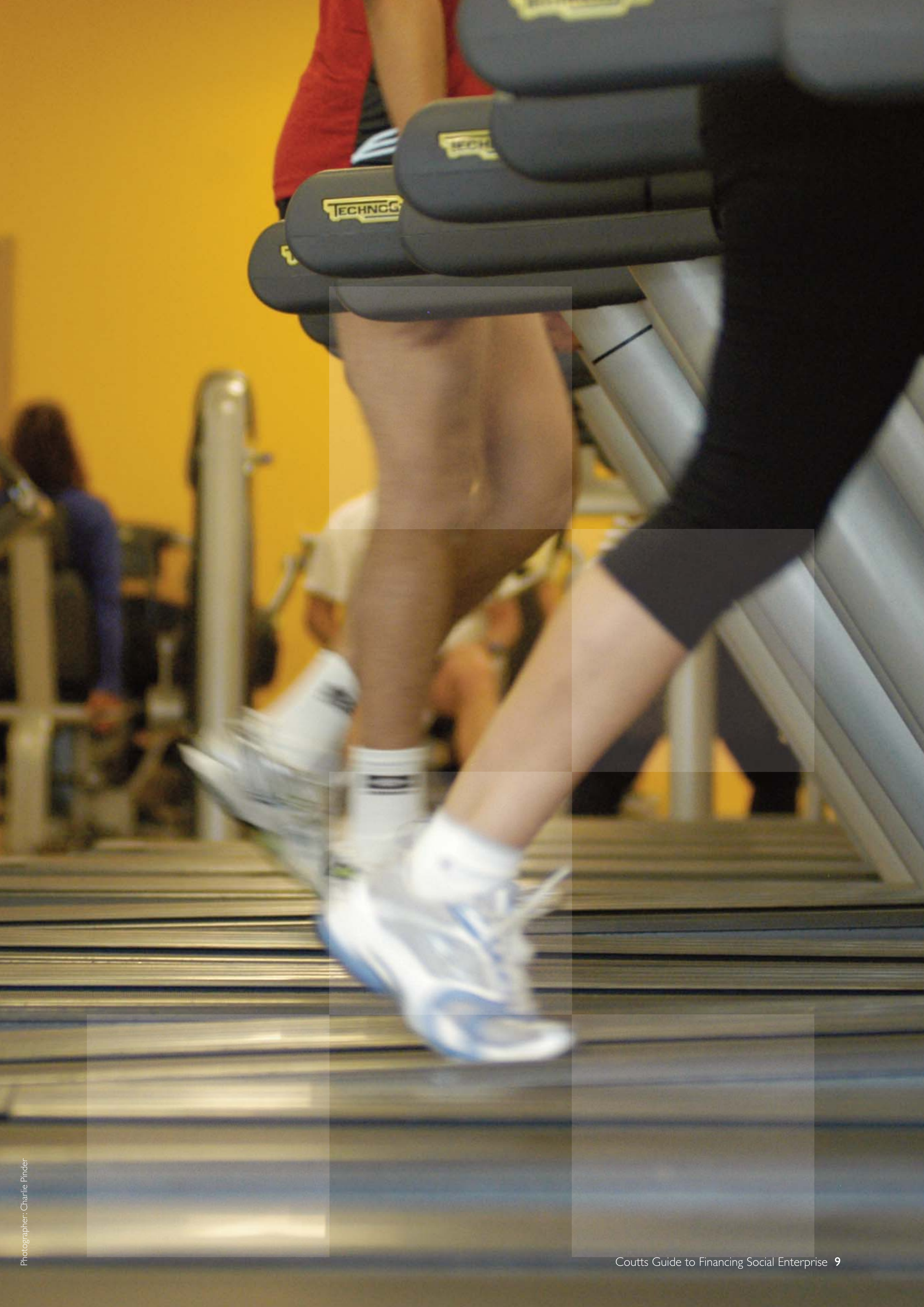
However, they caught the attention of Channel 4, which has two criteria for investment in a business: one, that the business is socially driven, and two, that the business can make a good story for television.

Because PKB met both these criteria, Channel 4 invested £100,000 in them. Dan Heaf of Channel 4 said: "To my mind, Patients Know Best is a game-changing, noise making and innovative web start-up that sets out to fix a vital yet broken aspect of our healthcare system."

Mohammad says PKB is seeking further investment to continue to develop, but that he would delay growth until he finds the right investor. "PKB is focused on the customer, and that means we need the right kind of investment. Our experience with Channel 4 showed us that it is worth waiting for the right match."

"The fact that patients don't have easy access to their medical records is a time waster, a drain on resources and potentially dangerous."

Dr. Mohammad Al-Ubaydli, Patients Know Best




Photographer: Charlie Pinder

# Development of the social finance and investment landscape – other useful information

Social enterprises face many challenges when trying to access mainstream finance. In an attempt to address the needs of this developing market, a number of social finance products have been created to support organisations that have social and environmental aims, not just commercial objectives. This creates new opportunities for investors who want to get involved with social enterprises. Below is a list of developments in the sector. These may prove useful to you when considering providing finance to a social enterprise.

### The Big Society Bank

The Big Society Bank is likely to be a wholesale bank rather than a retailer. It is intended to develop the market for social investment and is proposed to be funded by monies sitting in dormant bank accounts. The intention is for the bank to support the existing social finance intermediaries that are already growing the market for social investment in order to allow them to do more.

### Social Impact Bonds

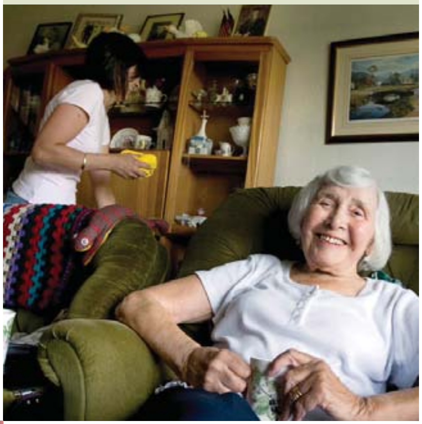
Social Impact Bonds (SIBs) are a new development to attract private investment to improve social outcomes. They are designed particularly to raise private capital for investment in the social sector and to fund preventative approaches to social issues, for example in reducing re-offending or unemployment rates, where it is possible to measure and account for the impact of any applied innovation to service delivery. There is a commitment from government to use a proportion of the savings that result from improved social outcomes, to reward investors that fund the intervention.

In March 2010, the first SIB was launched by Social Finance, together with the Ministry of Justice. It was designed to raise private capital for a social enterprise to help reduce re-offending rates of short-sentence male prisoners leaving Peterborough Prison. This product is only at the pilot stage at the time of going to print, but nonetheless, it has generated a lot of interest and is likely to become a growth area in the future for investments in certain social enterprises.

## Social loans

Social loans provide a flexible financing tool for social enterprises that will link investors' returns to growth in turnover and social impact. Transport social enterprise HCT Group (featured in the Coutts Guide to Social Enterprise) has raised £3 million to fund the growth of its community transport businesses. It created a new financing structure that provides it with flexibility, while connecting investors' yields to HCT's growth in turnover and social impact.

HCT Group and Bridges Ventures designed the financial instrument for the sector. The deal was led by Bridges Ventures, with support from the Futurebuilders Fund. Previously, social enterprises such as HCT Group were limited to regular forms of borrowing when they wished to raise capital, due to an underdeveloped social investment market. This put them at a competitive disadvantage to their private sector counterparts because they could not offer potential investors the opportunity to share business risk and obtain potentially greater financial returns. The social loan allows returns to investors that will increase (or decrease) in line with the organisation's turnover.



Photographer: Steve Forrest

Photographer: David Kapay

# Financing Social Enterprise Key Contacts

**Big Issue Invest**
Big Issue Invest provides medium-term growth capital for social enterprises that have a clear social purpose, compelling business model, strong management and which can demonstrate a sustainable revenue stream and growth potential.
**www.bigissueinvest.com**

**Bridges Ventures**
Bridges Ventures is an investment company whose commercial expertise is used to deliver both financial returns and social and environmental benefits.
**www.bridgesventures.com**

**CAF Venturesome**
CAF Venturesome manages a £10 million fund, made up of charitable funds donated or lent by Charities Aid Foundation, donors, foundations and banks. The funds are used to provide capital for charities in the form of underwriting, unsecured loans or equity-like products, tailored to meet the individual needs of the charity.
**www.cafonline.org/Venturesome**

**Charity Bank**
Charity Bank finances charities and other civil society organisations that address society's needs, with the support of depositors and investors who want to encourage a more responsible and transparent use of money.
**www.charitybank.org**

**ClearlySo**
An online marketplace for social business and enterprise, commerce and investment, it acts as a hub for social investment. ClearlySo also sits on the Coutts Social Enterprise Advisory Panel.
**www.clearlyso.com**

**Coutts Philanthropy Team**
The Coutts Philanthropy team provides advice on developing philanthropy strategies including venture philanthropy and investing in social enterprises.
**www.coutts.com/philanthropy**

**Investing for Good**
Investing for Good is a specialist adviser for impact investments to private banks, asset managers and foundations.
**www.investingforgood.co.uk**

**Social Enterprise Coalition**
The Social Enterprise Coalition is the UK's national body for social enterprise, representing a wide range of social enterprises, regional and national support networks and other related organisations.
**www.socialenterprise.org.uk**

**Social Investment Business**
The Social Investment Business is a social investor whose mission is to help the third sector do more of what it does best – supporting people and communities most in need. It provides capital, business support and long-term strategic thinking.
**www.socialinvestmentbusiness.org**

**Social Finance**
Social Finance's ambition is to enable greater access to a variety of investment instruments. They are developing financial products that marry the needs of investors, the sector and support organisations in their efforts to deploy and raise capital, and research social investment markets and opportunities.
**www.socialfinance.org.uk**

**Triodos Bank**
Triodos Bank, winner of the Financial Times Sustainable Bank of the Year Award in 2009, lends to and invests in organisations that benefit people and the environment.
**www.triodos.co.uk**

**Unity Trust Bank**
Unity Trust Bank is a specialist bank for social enterprises, charities and trade unions.
**www.unity.co.uk**

**UnLtd**
UnLtd's mission is to reach out and unleash the energies of people who can transform the world in which they live. UnLtd's Millennium Awards provide practical and financial support to social entrepreneurs in the UK. UnLtd also sits on the Coutts Social Enterprise Advisory Panel.
**www.unltd.org.uk**

If you would like more detailed information about Coutts range of services in this sector please visit **www.coutts.com/entrepreneurs** and **www.coutts.com/philanthropy**

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