UNLOCKING THE POWER OF CREATIVE CAPITALISM THROUGH SOCIAL INVESTMENT

June 2013

Legal & General

CAF Charities Aid Foundation

Foreword

Companies are increasingly being judged on their ability to deliver positive social and economic impact. To achieve this, we need to understand how the economy and society is reconfiguring itself and where it needs our support. As part of our commitment to creating sustainable futures, Legal & General (L&G) are actively seeking out new and innovative ways to generate both economic and social impact from our activities and investments, both for society and for ourselves. This is enlightened self interest and the basis from which we think the roots of truly sustainable business grow.

Social investment presents just such an opportunity. We believe in a market that supports and encourages investment activities, which are designed to deliver economic growth balanced with meeting the needs of society and the planet as a whole.

However, we also recognise that this market is in its infancy and that much more needs to be done to stimulate both supply and demand in this sector.

We believe that growth in social investment is dependent on the market's ability to respond to some key questions:

- Does the market believe that there is a need for capital to flow specifically into socially purposed businesses?
- Which investors have the money, the knowledge and appetite to invest?
- Where are the real capital needs in the market?
- What is the nature of the investment risk and who takes on that risk?
- Who defines and certifies 'social purpose'?

CAF's research, carried out by TNS BMRB, starts to tackle some of these fundamental questions and asks who else is engaging with this market – "Is the Investment Community starting to see the value that this market provides to the economy and society at large?"

We see this value and are realising it in our own business through our commitment to a number of initiatives, whether through our employees mentoring social entrepreneurs, running the first corporate community focused social investment fund (SE-Assist) or looking at how to develop socially focused savings products.

We hope this research debunks some of the myths, reasserts some of the truths, and lays bare the pathways for action so that many more will follow where we have started to tread.

Graham Precey
Head of Corporate and Social Responsibility
Legal & General Group Plc

Message from Charities Aid Foundation

Social investment is a concept that has massive potential to transform communities, make huge strides for the good of society and enhance the social, cultural and environmental state of Britain today.

Harnessing the power of capital to deliver a social return as well as financial rewards is a simple idea whose time has come: more than that, in circumstances of public sector austerity and squeezed incomes, it is essential to modernise and strengthen the social fabric upon which Britain's economic strength depends.

David Cameron, in a speech earlier this summer, declared that "social investment can be a great force for social change on the planet. It can help us to build bigger and stronger societies."

Britain has the potential to become the world leader in social investment. We need to make it clear that our great financial institutions are open for social investment business.

But despite the rapid growth of social investment over the past decade, the simple idea that investment can yield more than monetary profits is either unknown or regarded as unacceptably risky. There are too many perceived barriers to making the social investment dream a reality. That needs to change, and change now.

Earlier this year Charities Aid Foundation (CAF) and Legal & General (L&G) embarked on a major project to gauge attitudes to social investment. What we found was a deeply worrying lack of awareness of the concept and demand for social investment across mainstream financial institutions. Indeed, there is a widespread and damaging perception that social investment is mired in complexity and even runs contrary to regulatory controls. Across Britain's financial institutions, there is a cultural unwillingness to engage with a new way of viewing returns on investment.

Social investment needs to become an everyday part of investment policies by the major banks, pension funds and other parts of corporate Britain. We need to change the way we look at investment if we are to deliver the dream of unleashing this great force for social change.

Amy Clarke
Head of CAF Advisory
June 2013

Key report findings

Charities Aid Foundation (CAF) and Legal & General (L&G) believe that the report findings highlight the need for activity in three main areas, summarised below:

1) **Products and Services**
Financial services companies have a crucial role to play in developing the social investment market through the products and services they provide to customers. Retail and investment banks, as well as pension providers, need to consider ways they can incorporate social investment into their mainstream commercial operations both in the provision of products and activities to support investment of corporate (e.g. treasury monies) and customer assets.

2) **Government and Regulatory Endorsement & Support**
The Government and key regulatory bodies such as the Financial Conduct Authority (FCA) need to demonstrate their support of social investment and act to dispel myths about regulatory barriers to social investment initiatives. The Government should continue to promote understanding of social investment among financial services professionals so that the UK can become the undisputed world leader in social investment. Regulators should clarify that social investment is a valid form of financial activity so that companies have the confidence to enter the market.

3) **Marketing the Value**
Charities and social enterprises, as the potential recipients of social investment, must take responsibility for articulating the social value they produce and developing appropriate forms of measurement. These forms of measurement must reflect the requirements of investors in terms of evaluating risk and reward.

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TNS BMRB

This report has been written in collaboration with CAF Venturesome. CAF's award-winning social investment arm, CAF Venturesome, is one of the most established and active players in the social investment market. Since 2002, we have supported more than 360 charities and social enterprises with £30m of affordable finance, enabling them to flourish.


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1 Aims and approach

Charities Aid Foundation (CAF) and Legal & General (L&G) are keen to support financial services and other large businesses to enter the social investment (SI)* market. Whether driven by philanthropic or commercial motivations, they believe businesses have an important role to play by working together as investors and building delivery vehicles that support social investment and social enterprise.

CAF and L&G believe there is an increasing appetite amongst businesses to engage with social investment. To drive interest and encourage greater levels of activity, they decided to gather evidence of current market perceptions and attitudes to this exciting area of development. They commissioned TNS BMRB to conduct qualitative research with the ultimate aim of using the research outcomes to stimulate greater levels of debate and to increase engagement in social investment. TNS BMRB is an independent research agency, specialising in political and social research.

This research sought to understand how businesses currently view social investment as well as their motivations for and barriers to engaging with it. Through this, we aim to identify pathways for different organisations to become involved, and inform the development of new vehicles and products.

We undertook two stages of research and development. This allowed us to identify key issues and develop ideas that we tested in the market place, which led to the recommendations in this report.

In Stage 1 of the research we conducted in-depth interviews with 20 businesses that demonstrated an interest or are actively engaged in social investment:

- 13 private investment and retail banks;
- 1 foundation;
- 3 social investment experts (consulting); and
- 3 social investment market builders.

In Stage 2, we built on our analysis through discussions with CAF and L&G and then interviewed 12 additional individuals and organisations, comprising four business schools, two social entrepreneurs, two pension providers, a large business, a private bank, and two social investment market builders. We tested out key ideas, explored what is needed to enable greater levels of social investing, and validated the key findings from Stage 1. We used workshops with CAF and L&G to relate the findings to practical considerations and determine action-based outcomes.

This report presents the findings of the research and raises practical questions and considerations that flow from them. The report is intended to stimulate debate, encourage stakeholders to convene around these questions and help drive specific actions and agreements.

*For this research, the interpretation of social investment was 'the provision of capital to generate social and financial returns'.

2 Setting the scene

All research participants support the principle and mission of social investment, which includes the desire for market growth. They are either fully engaged, or interested in exploring what their roles in this market can be. Participants' willingness to contribute to the work, and their enthusiasm to learn more about social investment or to offer expert advice attested to this. Corporate investors, financial services and social investment market builders all saw great potential for the development of the sector.

"It's an incredibly interesting sector to be in and we know that, we have clients that ask about it. It makes sense for us to be involved and to be able to inform and talk to clients about it." (Private Bank)

The ambition is to create an investment market that efficiently matches investors with investees across a range of risk-adjusted returns. Participants are confident that although the market is nascent, it will mature rapidly and with this will come greater liquidity, commercial involvement of financial services and businesses, and access to the retail market.

Due to its infancy, social investment presents a number of practical uncertainties for potential investors and financial intermediaries, which increase the perceived risks and currently function as barriers to engagement.

Our discussions focussed on moving from gaining support for social investment in principle to practical implementation. Participants felt that the 'mindset' around investing needed to shift to drive changes in behaviour and a greater level of dynamism. Much of the social investment sector's work would therefore be addressing uncertainties through education, promotion of examples and stimulation of competition. Participants expressed interest in identifying ways to overcome inertia and seek answers to the questions regarding implementation of social investment, both through clarification and trial and error.

3 Stimulating demand and competition

Demand for social investment among financial services providers is hindered by low awareness of how it can be used to meet their clients' investment requirements, as well as a lack of understanding among some participants of the appetite for social investment among their clients. This is used to justify inertia among private banks and advisors.

"The main point is that there needs to be more awareness of the space. I don't know any social investment funds, I think that many people don't know about it, unless you're operating in the space." (Private Bank)

In a few cases, participants knew of clients that had enquired about social investment, but few advisers in asset management were aware of social investment and were not introducing or discussing it with clients. Several banks demonstrated knowledge in this area and described recent developments in their social investment activity, but were not sharing these with their clients or peers. However, social investment market builders saw financial services providers as the most critical players in moving social investment forward. In their view, the current lack of intermediation is resulting in a disconnect between social investment opportunities and what investors are looking for.

To tackle inertia, greater education, promotion and competition amongst peers is critical. This can be achieved through generating client interest, encouraging peer comparability and co-opting senior level commitment from financial services providers.

To overcome the chicken-and-egg scenario of low awareness and low impetus, participants suggested the need to:

- encourage banks to introduce social investment into their portfolios;
- promote activity of banks that have started to advise on social investment and create social investment impact funds;
- raise awareness of competitor activity and spur others to move forward as well. Businesses said they would certainly respond to signs that their competitors were ahead of the curve; and
- introduce social investment to clients and stimulate

Questions

How can we stimulate competition in relation to social investment?

What communications and education are required to increase advisors' impact and engagement?

Can the power to convene to raise awareness and educate act as an effective tool to driving social investment activity?

What role can the Social Banks such as CAF play in encouraging cooperation amongst the corporate sector?

Actions

Social Investment Finance Intermediaries (SIFIs) and social investment market builders should generate evidence of client demand and financial services' activity, to demonstrate growth of the market.

Regulators should provide guidance and reassurance to advisors on how to advise on social investment while meeting fiduciary responsibilities.

demand by providing resource to help financial services to offer advice on it.

At the adviser level, incentives and training were considered critical. Businesses need to support advisers who could:

- work through incentives structures that encourage social investment (although rules governing fees may have changed, the financial incentive for higher financial return investments has not disappeared); and
- be trained for increased confidence and knowledge of social investment as an option among investments.

To generate demand for social investment, the branding and marketing of both social investment concepts and products was considered essential – and something which has been lacking. Establishing a brand that people trust and understand, stakeholders suggested, is a key part of the challenge. Stakeholders applied this idea to the public, but also to the way advisers could take these ideas to sell social investment.

"Brands create inclusivity. If you create a brilliant brand that the public believes in then you create a product...what you haven't seen is brand building in the field of social investment that is appealing to the broad mass of the public. You could call that education but I'd just call that marketing."
(Social Entrepreneur)

Although social investment has not entered the retail market, participants expect a strong public appetite for it. Pension providers and stakeholders speaking on their behalf can see a good fit with customers – the barrier to generating demand is investors' own execution.

The best role for Government in this sector was quite contested. Government is expected to carry the policy risk associated with developing new ways to deliver public goods and to incentivise businesses with a monetised argument for entering the space. However, participants were clear that commercial success would depend on the viability of the market, which Government should not seek to control. The challenge is in striking a balance between stimulating demand through incentives without undermining the trajectory of the sector towards sustainability.

4 Addressing risks

Private wealth asset managers, investment managers on pension funds, and retail banking services are key groups voicing concerns about how they would vouchsafe their practice if they introduced social investment.

Risks related to risk-adjusted returns in investment decision-making, as well as wider potential impacts are summarised below:

1) Compliance risk
   Advisory risks were attributed to the Retail Distribution Review (RDR). Participants expressed concerns about how they can demonstrate that they are giving the best advice on a non-transparent sector.

2) Execution risk
   Without a track record on returns and with few examples to guide them, asset managers struggled to establish risk characteristics and determine a risk-adjusted return. They did not see the returns as justifying the risk, though there is debate among long-term investors on this question. Arguments for a diversifier offering a better risk-adjusted return are strengthening, but assuring their fiduciary duties are met remains a challenge.

   "There is no conception of this as a serious model. We're not clear enough about the returns, or how to make a risk-based assessment." (Pension Fund)

3) Market and policy risk
   Asset managers' disappointment in the performance of renewables coloured their perceptions of the risks and viability of social investment. With heightened concerns about policy risk as a factor, they sought clear policy signals that the current and future Government supports the market.

   "To the extent this market is driven by policy, to the extent there's policy risk these investors will tend not to seek to change their investment portfolios from the way they have done historically so there's a lot of inertia. If the public sector is worried about policy risk, the private sector will simply follow suit, and understandably." (Business School)

Questions

How can companies engage regulators to validate social investment activity further, thereby reducing perceived regulatory risk?[1]

How can fiduciary duties be addressed as a non-risk for social investment?

What clear policy signals are needed from Government to assure investors about this marketplace?

Actions

Engage professional and trade bodies to issue guidance addressing misperceptions about compliance and risk.

Find communication platforms for social investment pioneer investors to share their experience and challenge peers' assumptions about the risks of social investment.

1 In addition to the Law Commission's review of fiduciary duties of investment intermediaries; and recent FCA advisor assurance.

4) Reputation risk

The necessary exit from an investment in an unsuccessful organisation was seen to pose a serious reputational risk. This risk was not felt to merit the potential reputational return.

"If they could get their money out by insisting on the venture closing down? Commercial bodies don't want to be seen to be the people that close the charity down. That's the cultural barrier that nobody is fully addressing." (Social Entrepreneur)

"Businesses are unsure about being tied into providing an essential service." (Pension Fund)

Arguably, these perceived risks present questions regarding the viability of social investment, which have the potential to be resolved if answers are sought. In many cases, perceptions rather than experience of risk hold greater sway. However, businesses need to adopt a solutions-focussed approach to their questions and seek to diminish the risks identified.

Actions that participants believed are possible, include:

- clarification on regulation;
- support in answering questions of fiduciary duty;
- pressuring Government for clarity and reassurance on the policy framework; and
- seeking out investments that feel sufficiently safe to stake reputation.

5 Articulating Business Value
Financial services

What is the benefit for us? What is the benefit for investees? What is the return? Can you show it creates good commercial value?

Commercially and financially, the business incentives are not clear enough for businesses to answer the questions above and overcome their inertia. While stakeholders agreed on the wider business value that social investment could generate through Corporate Social Responsibility (CSR) activity, it was rarely seen as a commercial investment opportunity within the UK – though impact investing overseas is being more widely explored.

"I want to be educated in all of this first to understand what's in it for us. And then understanding what's in it, what it involves and what are the implications for us in terms of resources needed to do it." (Private Bank)

There is a consequent tension between CSR divisions and asset managers as to where social investment is best placed within the business, and who would 'own' any social investment fund or activity.

"Where does a fund actually sit? There are people who are saying well if it's not profitable, I don't want it in my division as it's a drain on head count, especially if it's not generating income. So there's been an interesting discussion." (Private Bank)

Currently, traditional revenue models are not assumed to work in the social investment space on account of the small scale of investments, a higher proportion of due diligence required, and a lower financial incentive for deals. Many financial services were, therefore, unclear about what a commercial model would look like. They did not expect to 'mix' social investment with traditional investing and were uncertain who would bear the cost of due diligence. Neither of these points posed a barrier in themselves – rather, they implied that significant resource would be required to introduce social investment to financial services, and fuelled doubt about its commercial viability.

Business Value	A differentiator – prove business is ahead of the curve Align customer and the business values Potential as a niche product
Division Value	CSR – Corporate responsibility embedded in practice Loyalty – better relationships with sophisticated clients
Individual Value	Motivation by incentives that encourage social investment selling Expertise in all areas of financial services

"Where you have a large and highly fragmented market it means that our investment staff need to go and do that sort of due diligence, and you cannot put it in front of the client unless you can be clear that you have looked at every organisation in that sector. So I think that is one of the constraints." (Private Bank)

Regardless of the structure for resourcing financial intermediation, participants agreed that the 'value' of social investment had to be realised at every level of the business, from overall strategy, through to divisions and individuals.

Social investment would require strong support from senior teams, and clear incentives for investment managers and advisers to introduce it. As reputations and incentives are not built on long-term returns, success ratings would need to account for this. Here, the support of shareholders and stakeholders is also key.

"In these big organisations it has to come from the CEO or a very senior person. We all get a job brief and a job description, and we're assessed and appraised against those objectives. The reality is that it's not very smart to try and push something in an organisation where there's no appetite or where it's not been watered from above." (Private Bank)

Investors and advisers who considered themselves goaled towards financial returns described the difficulty in switching from a financial return maximisation mentality. They found it difficult to conceive of new dimensions of return that did not prioritse finance.

"Because the mindset of investing is always to basically try and make a return, it's rather like telling a 100 metre sprinter that the aim of the exercise is to come last." (Private Bank)

"Most people don't do the thinking for the bulk of their savings, they rely on intermediaries. Intermediaries will stay in a job to the extent that they make money quickly. You have to provide them with incentives to feel actually they can stay in their jobs and build a reputation and beat the market by investing in these other things." (Business School)

If the commercial argument became clearer, financial services could see wider value in social investment where it was framed as a niche activity that:
- assists client loyalty;
- acts as a business differentiator;
- aligns the business with these values; and
- embeds it within their practice.

These were all considered compelling reasons to introduce social investment.

Investors need convincing it is the right thing to do primarily from a risk and fund management perspective. There is little demonstrable evidence as yet to provide track record information that supports these decisions. However, a few pension investors are starting to consider the financial rationale for investments that they believe could be stable in the long-term. The financial and reputational aspect to social investment is increasingly attractive – offering a sound financial proposition while demonstrating social commitment.

"Say you've got a choice where your money goes and it will probably perform in a similar way – you can either build hospitals in your country or a motorway in Australia – it's interesting, showing that the environment you live in can be better too – it's quite win-win. It's surprising it's an argument that hasn't gained much traction."
(Pension Fund)

Investors anticipated customer support for schemes presented as good deals that also support the local community and UK society. Recent research suggesting that there is strong public appetite for impact investments also challenges inertia around the perceived lack of customer demand and bolsters optimistic voices within organisations[2]. As the pensions industry is seen as fairly conservative and in need of exemplars to stimulate competition, participants called for business leaders to inspire and explain how social investment could work for them.

Retail banks considered social investment to support existing work and to be in-line with their identities and reputation. They sought to be seen to champion small businesses and support social enterprise, and saw social investment in similar terms to their involvement in microfinance – offering a low but stable financial return, and good returns for reputation. They also foresaw strong public support for social investment, which increased their interest.

"I think the payoff, if you like, would be partly in the social good that we would facilitate. Partly from a sort of reputational point of view with policymakers and with the public at large. Because I think the public is going to get this more as time goes by." (Retail Bank)

Questions

The industry requires strong examples of promising practice to develop the social investment business case, but hard data on return rates will take several years to realise. How can case studies of effective practice be used in the meantime to promote development?

What incentive models could be developed to drive social investment innovation and activity?

What role can CAF, L&G and other leaders in this area play in coordinating action and encouraging leadership?

Are incentives for retail product innovation needed?

Actions

In the absence of immediate return evidence, develop a narrative around the risk of inaction. What will happen if we do nothing – in the third sector, to families, to communities and businesses?

Promote and circulate the work of Engaged X[3] in providing data to support estimates around risk-adjusted return.

2 *Social Finance and Finethic*, October 2012: Microfinance, impact investing, and pension fund investment policy survey.
3 The world's first financial index for impact investing, giving aggregated investment data for the market as a whole. http://www.engagedinvestment.com/engagedx.html

5 Articulating Business Value
All businesses

A few current examples of corporate social investment activity in financial and skills capital exist, and participants saw the move towards seeking business impact and generating business value as a good fit with social investment. This could be applied by a much larger group of businesses than are currently engaged. The onus on sustainability reporting and integrated reporting can help pave the way for its introduction as another way to generate business 'value' and meet its reporting goals in relation to environmental, social and governance factors (ESG). Linked to this, the use of social investment to balance the performance
of ESG factors within 'responsible' funds was also considered a 'route in' to the portfolios of responsible investment managers.

"They are trying to manage a triple bottom line – the social investment product can really help to re-balance a portfolio if they don't have enough social or environmental return so they can mix and match with class of product and rebalance it. This is a good category of investor who can make use of this type of asset." (Business School)

Social investment is easily aligned to corporate social responsibility (CSR) and in some cases, wider business objectives on social purpose. It also has a place within employee volunteering, championing local businesses and sponsoring charities.

"Companies have their own objectives and areas of focus, so it has to be a mechanism to help achieve the goal that the company has set. So if we said, we're going to help people from a health perspective through social investing, I think this kind of thing it would make much more sense for us." (Business)

Although stakeholders recognise a natural fit, the social investment case has not been framed in this way. The question therefore becomes how it gains currency within the business and sustainability agendas.

"My feeling is that often the business value is very strong if you do these things right. But inside most companies, people don't think this stuff drives value. So if you don't put the metrics around, and if you don't start measuring the business value, communicating it, then companies

Questions

What is the business case for social investment?

How can it be articulated while the evidence on impact is generated over time?

What might short, medium and long-term value generated look like?

Who can articulate this?

Actions

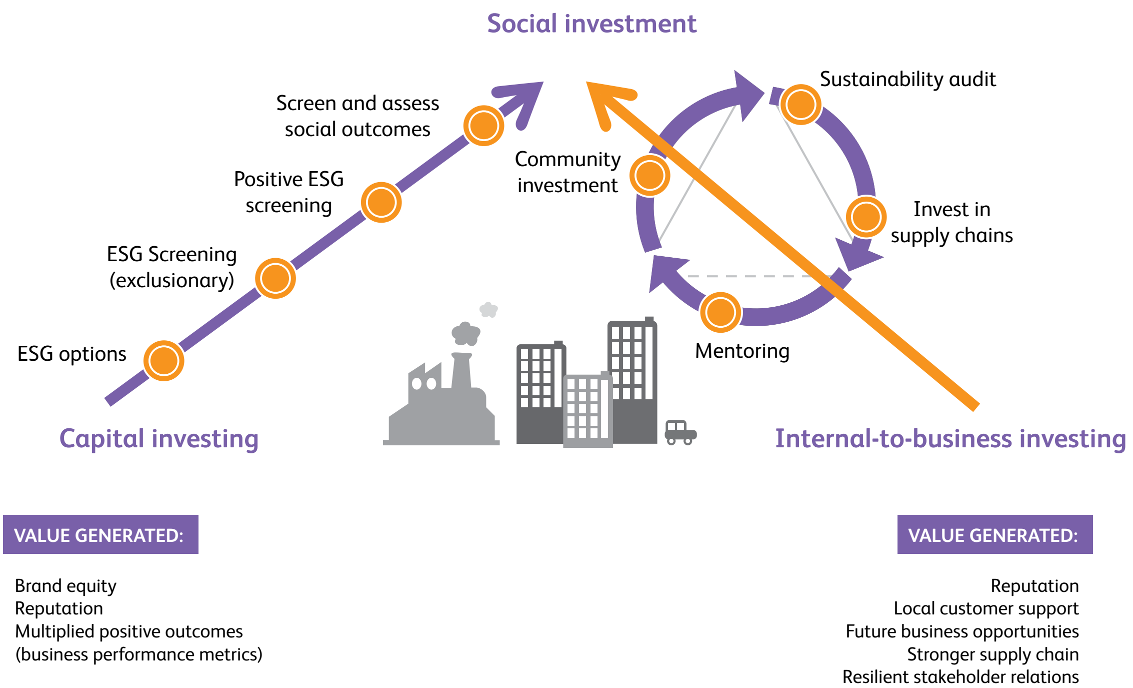
Reword the story of social investment to match business goals on impact, shared value and sustainability.

probably don't see a good reason to invest much...What I would like to see happening is for companies to start to manage this more like any other part of the business...that will then make it a much more solid and sustainable part of their on-going business." (SI Expert)

Aligning and matching social investment to short, medium, but most powerfully, longer term business objectives and value creation gives CSR teams more licence to introduce social investment into their businesses, and gain a wider level of support as a tool that can help achieve long-term positive outcomes. Businesses were clear that to demonstrate a business commitment to social investment and achieve more transformative social impacts, they required sizeable investment. Treasury budgets were agreed to be a potential source of investment with real liquidity. If these budgets could be accessed then the social investment market could see much larger levels of funding being made available as companies took the role of sizeable investors.

CSR participants were keen to engage their treasury, risk and investor colleagues in conversations about social investment, but felt they needed stronger evidence of business value and the impact of social investment on business, through anecdote, examples of others' activity and further supporting information. This could help move beyond a focus on short-term financial results into longer term visions, which is more likely to demonstrate the value of social investment and increase the capital available.

"It's about giving them [investors] a licence to consider other impacts, and opportunities to consider what else might be available. It still needs to return a profit to the business or why would anyone do it? But it doesn't start from a point of saying, you've been doing this wrong – it starts from saying, here are some shared goals, where we want to go long-term, we think there are opportunities for us to consider how we invest our funds and create and drive a range of benefits through what we are already doing, and create a dialogue that way." (Business)



6 Pathway to entry
Different entry points to capital investing

Different categories of investor have particular opportunities and constraints. Investors want to see vehicles that meet their criteria for a suitable investment – so marketing and product positioning need to be tailored to match them. Targeting different investors' entry points to social investment can help identify the gaps in funds and investing opportunities.

Outlined below are two key focus areas: Gateway and Transformational Investing

Gateway investing: social investment could be introduced through 'gateways' in the form of more 'vanilla' options such as social housing and clean technology. These would pose less risk to capital, but create a 'triple bottom line' return and function as a practical education. Pension funds felt suited to an asset allocation model with a regular yield and could feasibly diversify into social investment – a rationale supported by business school representatives, who agreed these asset-based investments offered good stability for long-term investors. Given the potential for the retail market to support social investment, this is an area pension funds are keen to explore.

"The niche that social investment offers is about better risk-adjusted return even if overall return is lower – those are the things that pension funds are crying out for. So in the past defined contribution schemes and defined benefit schemes went for lots of equities – now they're crying out for asset classes that do lots of different things. Social investment needs to find the niches in which they can say – well, it's not a 10% return, but you will get a 2% one, and there's a 98% probability that you'll get that year on year for the next 30 years." (Pension Fund)

Transformational investing: Foundations, Sovereign Wealth Funds, Development Finance Institutions and other organisations with a mandate to take on more socially responsible investments are expected to invest in the high-risk, high-impact ventures that participants believe can be 'transformational' in achieving social returns through innovation. This group is also expected to be the primary 'de-risker' for high-impact ventures, and businesses saw their role as partners or capital matchers. Other businesses suggested this is feasible if the investment is 'commercially interesting' and fitted with their business objectives.

Questions
Can successful examples of execution for different investor categories be found, both in the UK and internationally?

Actions
Identify and market investment opportunities suited to different investors at different entry points.

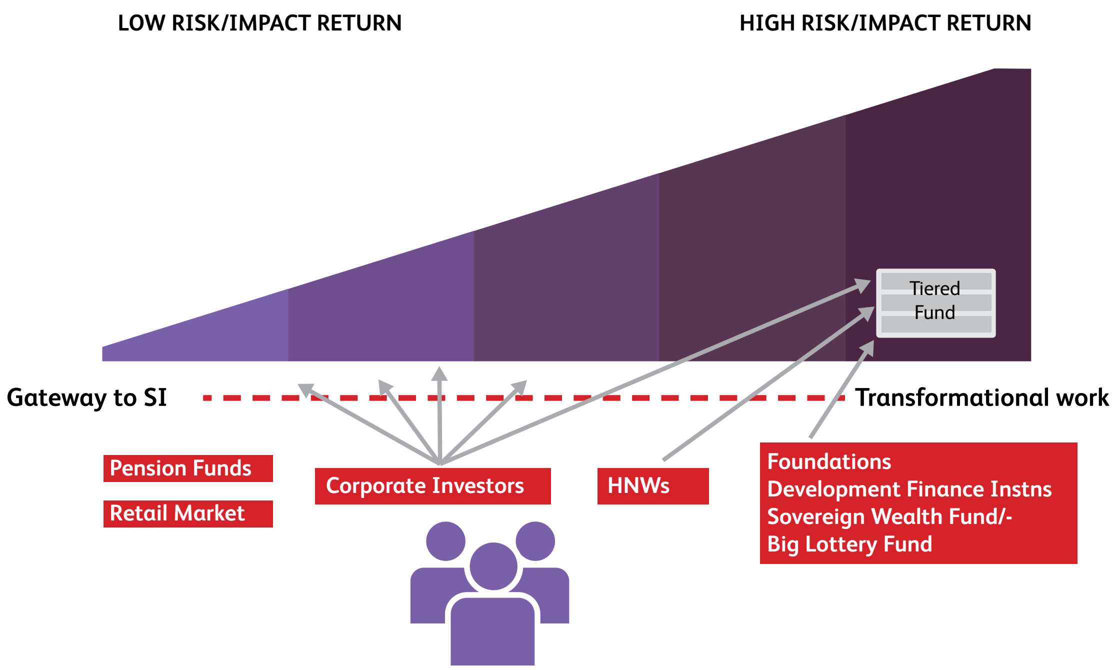
Identify actors to lead the creation of tiered funds and begin supporting the creation of partnerships.

Promote successful examples of social investment across the spectrum.

"There is an appetite to do this – they [foundations etc] also have a mandate to future proof their investments, so framing things could work much better with these categories of actors, versus the others who are looking for more economically rational return for their economically rational dollars invested, rather than future returns on present investment." (Business School)

"For us it's not been quite clear around how that fund structure would work– what we would like to see as a model in these early days would be perhaps Government taking a risk, so they might take a risky part of the finance, there might be a role for foundations to take a bit more risk and then there might be a role for mainstream, you know, insurance companies and banks to say well okay, given that some others are taking a risk in here we could probably participate and not take too much of a risk, but get a sensible return." (Retail Bank)

High Net Worth (HNW) investors have not engaged to the extent expected– but it is hoped that they will invest across the spectrum of options according to their interest. They are also considered useful contributors to any part of a tiered fund structure that fit their goals.



6 Pathway to entry
CSR

While Corporate Social Responsibility (CSR) activity is seen to have a natural fit with in-kind (sharing of relevant skills and intellectual assets) social investment, it lacks large budgets, often lacks metrics and remains internally driven. Within businesses, what gets measured tends to be what gets done first. Unless social investment of every type is incentivised at the individual and division level, it will not gain traction. Hence, building social investment into incentive structures is important.

CSR social investment pioneers can lead a process of cultural and behaviour change by introducing and diffusing social investment concepts and practice into other business divisions. Using CSR budget, teams can introduce small investments and mentoring schemes to familiarise other divisions with the concept and use this as practical education for ‘financially goaled’ investors. This ‘learning by investing’ is the practical side of other efforts to articulate business value to investor divisions, as discussed above.

To move social investment beyond CSR budgets, a compelling business case needs to be made to asset managers, risk professionals and the highest levels within business strategy. All participants emphasised the importance of endorsement from a CEO or senior leader within the business and access to treasury budgets to enable investing that achieves greater impact. It also needs to feed into procurement policy if it is to influence trading and supply chain investment.

Questions

How can social investment be built into incentive structures to goal employees in a target driven culture?

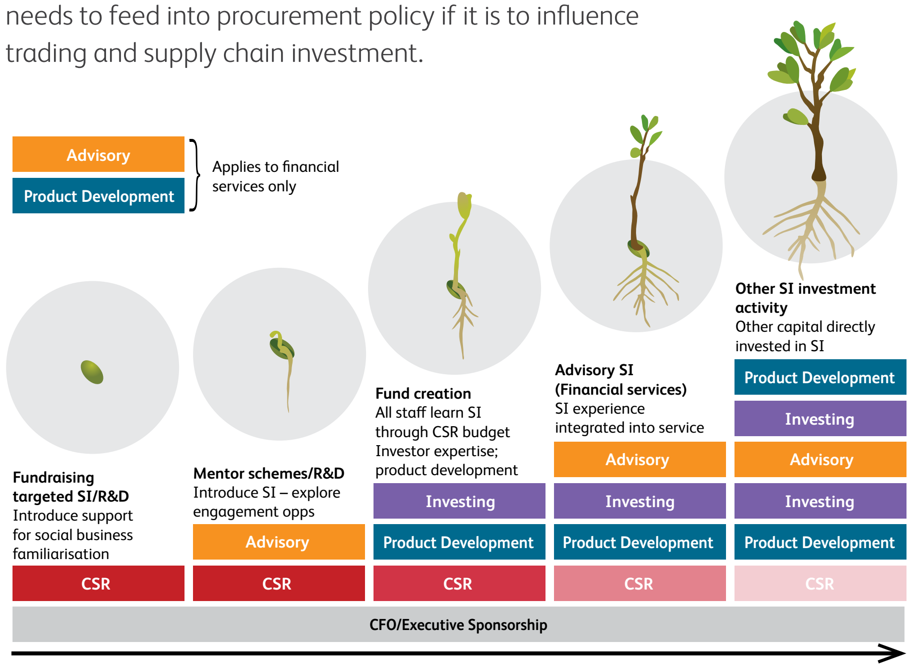
How can Social Investment Finance Intermediaries (SIFIs) help CSR teams to match business with social enterprises and develop social investment schemes to suit both parties?

Actions

Map current CSR activity against the model, showing its application to different types of business.

Perform analysis to show how CSR incubation can grow the social investment market: Estimate current CSR spend and the potential uplift to the market if a proportion of this was spent via social investment.

Provide CSR professionals with the tools and evidence to demonstrate value of social investment to internal stakeholders.



6 Pathway to entry
Structures

Stakeholders agree they need to increase absorptive capacity and create appropriately scaled packages, as there is a mismatch between what social enterprises are ready for and what the financial services industry are used to providing. More broadly, businesses should be mindful to avoid a 'supply-led bubble' of strategy without up-to-date understanding of social enterprise demand.

The market is seen to need more liquid investment so that investors can free up capital more easily. Social investment is considered possible across all asset classes; hence investors should see its wider potential rather than simply as a sub-set. Though it is still hard for SIFIs to value shares, this is expected to become easier over time.

"You can have sustainable profit optimisation with a social purpose across all the asset classes." (SI Market Builder)

Investors and infrastructure builders have the challenge of de-risking tranches of capital, creating structures that enable liquidity of investments and building scalable structures to grow the investment market.

Stakeholders believe large financial institutions have excellent opportunities to enter into partnerships and collaborate with organisations dedicated to innovations in social finance, and that their infrastructure makes them best placed to create scalable structures. They suggest there is a role for mediators to bring people together and act as catalysts for experiments in structuring new finance models. For example, large banks could seek partners such as Truestone or Big Issue Invest (informed by examples of these partnerships already in place) to create more liquid, high social impact investment opportunities in a joint venture that aligns with their goals.

Different businesses expect different levels of connection with their investee, which will be an important dimension to successful investor-investee agreements. Stakeholders stressed the importance of aligning investors' expectations with those of social enterprises. Areas of support identified include defining the relationship businesses will have with investees and relevant considerations to decide this.

Social investment funds may be easier to manage as a less risky method that offers a degree of specialisation (e.g. by social issue); however, this could dilute an investor's relationship with the investee and their direct mission. A variety of relationships are possible, each with trade-offs that should be considered by potential corporate investors.

Questions

What would help ensure 'supply side' social investment stays attuned to 'demand' side social enterprise needs?

What incentives do SIFIs need to support the creation of partnerships?

Can transactions be marketed to encourage clear options for extent of connection?

Actions

To inform development of supply-side structures, work with social enterprise representatives to map capital and skills gaps.

Convene product developers, SIFIs and social enterprise representatives to devise funds and transactions of different levels of connectivity and specialisation.

Collate and promote the best examples of social investment structures to date. Consider prizes and awards for innovation and impact.

Hold a sponsored event or publication focusing on investor-investee connections. Showcase successful products and relationships. Advise investors and investees on what to consider to determine the best match.

6 Pathway to entry
Markers and access to information

Participants agreed on the need for a practical way to identify social investments according to the returns that were sought, in order to match and align specific social investment options to investors' specific objectives. Rather than a certification as such, investees could be responsible for holding themselves accountable to known descriptors if these were held in common, easily recognised and standardised. They felt this will bring transparency to the market and will map information about investees to increase accessibility for newcomers. This will also enable financial intermediaries to filter options, locate appropriate opportunities and connect supply with demand.

Participants agreed that this practical commercial application of social investment could bring much-needed clarity to investment activity, by showing what is and is not viable social investment at various risk and reward levels.

"It gives an identity to potential investment and gives flags for capital, where they might go, and leads to an equal system that could lead to sustained intermediaries and advisers in the sector." (SI Market Builder)

The requirements for this are:

- Accessible information about investees;
- Ability for financial intermediaries to filter options;
- A threshold test on minimum criteria for social purpose[4] and a social and financial return – to exclude any other activities and mark the 'dual return'; and
- A spectrum, or scale, that categorises investments from 'mostly financial' returns to 'mostly social' returns. This specificity could enable an advisor to match a given fund or social enterprise to the type of activity and return that the investor seeks. This spectrum would reflect the structure of the 'investable' organisation and the nature of their activity.

Without this, participants believe the variety in language and terminology used to describe social investment could cloud quite simple concepts and act as a barrier to investors' confidence in the sector.

As well as investing financial capital, other activities could accompany social investment. Activities including offering employees' time, knowledge and skills to support social enterprises, and trading with them are perceived as worthwhile and could bring real benefit to the social enterprise sector. To generate support of this kind, greater clarity is needed about which of the activities would be most useful.

Questions

Accepting the requirements described above, how can regulators strengthen its utility?

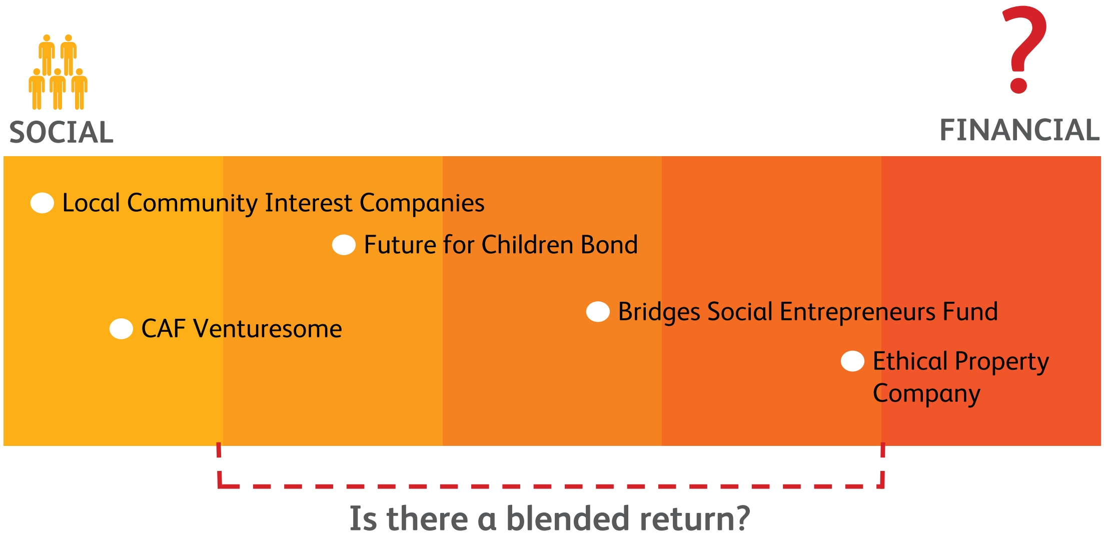
Actions

Use the definition to size the market to increase commercial confidence in social investment.

Determine where and how to place different social enterprise structures in the definition.

Define other, non-financial types of social investing activity and include them in the working model of social investment.

4 Note: in defining 'social purpose' and the notion of responsibility, questions about tax behaviour and employee welfare were also considered pertinent.



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6 Pathway to entry
In-kind investing

Financial services and social investment market builders currently question whether a different system for financial intermediation is required for social investment rather than attempting to integrate it into investors' current approaches. Social investment market builders suggested that the engagement of financial professionals in social investment work may require a separate stream of activity within the business. Whether these become permanent positions or function as 'alternative' routes at a point during the person's career, the value and incentives to employees would hinge on goaling towards social impact achievements rather than financial reward.

In addition, businesses can play a number of roles in facilitating social enterprise development. Trading and support in-kind are both hugely important to their growth. The role businesses can play in mentoring, information and advice should not be undervalued.

"There's a lot of mileage in that, and it hasn't been emphasised until recently, because people have been thinking, well wouldn't it be great if it was purely commercial - and it would be, but it's not".
(Social Entrepreneur)

"Skills capital is the biggest gap. The key challenge is getting social enterprises investment-ready."
(Business School)

Businesses expressed interest in this form of investing but believe it must be geared to the needs of the social enterprise. Determining early on what kind of support the social enterprise needs is important to its success. Depending on the goals, employees may need to go deep enough into an organisation to understand its needs. But a light touch approach incorporating sharing of skills and services has also been useful. Anecdotally, the coupling of in-kind support and capital backing was found to increase the stake and commitment that the corporate has to the investee.

Social enterprises need financial advice and management support to help them operate effectively as sustainable businesses. Retail banks are experts in servicing SMEs, bringing manufacturing, distribution and credit understanding, with national networks of relationships at the community level. They could apply this knowledge to social enterprise support despite being constrained in their lending by regulatory burdens.

Questions

Can social investment market builders and SIFIs match and connect businesses with social enterprise for in-kind support?

What information and guidance should be available to businesses to inform their development of mentoring schemes to support social enterprises?

How can retail networks best be leveraged to support social enterprise?

Actions

Disseminate 'what works' so far, from both investor and social enterprise perspectives.

6 Pathway to entry
Metrics for returns

Finding robust, common metrics on social impact that can be standardised across businesses is seen as a powerful way to spur social investment activity by benchmarking achievements and creating a competitive dimension between businesses. This is hoped to help businesses monitor, enhance and promote their social impact in their reporting.

"Measurement, I think, is crucial. It's going to be especially in terms of getting other investors on board, I think - having things that we can talk about, results that can be easily demonstrated rather than a whole range of things that allows you to compare us." (Private Bank)

Beyond financial return on capital investment, dimensions discussed were:

- Systems efficiencies – 'hard' data on efficient resource use and performance, 'soft' data on employee engagement, retention and wellbeing. This includes impacts on resilience of stakeholder relationships and supply chain.
- Commercial outcomes – brand value, reputation and potential for future business e.g. entry into new markets and product development.
- Stakeholders agreed that SROI metrics could be usefully applied to social investment.

The level of reporting requirements and expectations of all parties is a crucial part of a social investment transaction. Businesses' motivation to attribute social impacts has to be balanced against what is feasible and useful to social enterprise. While developments in SROI and reporting metrics are fast-paced, social entrepreneurs have found enterprises can be hamstrung by complex instruments that prove onerous to resource and of little utility. For reporting to work, it must be a manageable burden that supports the social enterprise to improve its performance.

"Financial services view the measurement and mechanisms as they would with other sectors. But there's a mismatch in expectations for reporting and results....the organisation [social enterprise] has to benefit, and the burden needs to be brought down to a manageable level." (Business School)

Questions

What indicators should be used to develop a social investment SROI model?

Can social investment be integrated into existing benchmarks?

What indicators will best drive further investment?

Actions

Agree and disseminate recommended indicators to drive standardisation and comparability.

7

Actions

To grow the social investment market

The research identified a number of key actions to enhance the Social Investment Marketplace.

- Businesses need a better awareness and knowledge of the social investment concept and practice. A lack of market competition and evidence of demand and perceived risks justifies little action.
- There is a need to overcome cultural barriers, both in investors' approach to risk-adjusted returns, and in attitudes to CSR activity
- Better branding, marketing and communications in the sector can shift this dynamic and drive awareness, education and competition.
  - The branding and communication of social investment can develop a new story on the business case for investor decisions and the value that it brings.
  - Communications should target specific categories of investor, using case studies and successes to help them consider which investments and activities best suit their own objectives.
- The strongest incentive is keeping up with the competition through leadership – so businesses that can lead and champion social investment activities will do the most effective job in bringing others along with them.
  - The message is strongest if it comes from people with the same expertise and lexicon who can demonstrate success in terms that their peers will acknowledge.
  - There is a need for leaders from each investor category, and for groups of professionals to convene and share this knowledge.
- Businesses and their staff face no legal or regulatory barriers to greater engagement but need to be supported by the right incentives – both carrots and sticks – and by practical guidance that supports them in meeting their fiduciary duties.
- For capital investing, a shared definition is needed to aid investors and advisors in navigating this new area.
- There are multiple entry points for different categories of investor. 'Gateway' investment can introduce cautious investors, while 'transformational' investment options can be de-risked to encourage corporate involvement in innovative work.
- Participants support the concept of sustainable profit optimisation with a social purpose. 'Optimisation' rather than 'maximisation' is accepted within mainstream investing, and the social investment market should play to this change in outlook.
- To access treasury budgets for social investment within businesses, CSR teams need to articulate the business value of social investment and persuade risk and investment colleagues. They will depend on others' data on their activity, and the support of others within the social investment sector, to make their business case.
- Government is expected to send clear policy signals that reduce perceived policy risk, incentivise entry into the market, and support development of the social investment infrastructure.

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