10th ANNUAL CHARITY FINANCE CONFERENCE

CHARITY FINANCE DIRECTORS GROUP (CFDG)

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SOCIAL INVESTMENT – A CHARITABLE ACTIVITY?

Introduction

1. Why finish off the CFDG Conference with a lecture on Social Investment? It may seem a bit marginal as a topic given all the other preoccupations and issues with which charity finance directors are grappling currently and that you have been debating today – for endowed charities like the one that I (and your Chair) are employed by, for example, discussion is focused more on issues like Total Return, the ending of the transitional protection that has eased the impact of the removal of tax relief on dividend income, the impact of the Trustee Act, crazily volatile equity markets, growing encouragement for charities to go for Socially Responsible Investment, the latest batch of revisions to the SORP
2. I proposed it as the subject of this session because I believe Social Investment is a mainstream and current issue for charities – and I hope that over the next 30 minutes or so I can persuade you to think so too. But, hang on, I hear the sceptics groan, the Social Investment Task Force was just another "Blair New Labour Social Inclusion Joined Up Government" initiative to get financial investment in business enterprise and wealth creation in poorer communities – recommendations about venture capital, bank disclosure, tax credits, support for profit-making small businesses – what's that to do with charities??
3. Actually, quite a lot. And not just for grant making Trusts and Foundations – the issues raised by the Task Force report are directly

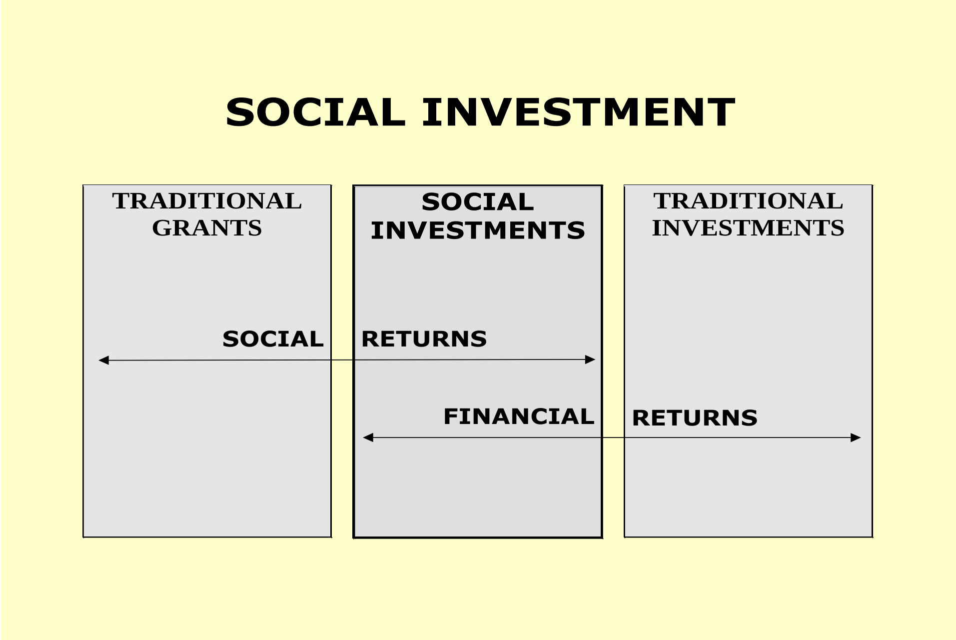
relevant to all charities that have the relief of poverty, regeneration or community development among their objects; they also address an issue – Programme Related Investment (PRI – something I hope that the Chief Charity Commissioner may have spoken about this morning) that is relevant to all charities, whatever the focus of the charitable objects. I'll come to all that later – first, what is Social Investment and what did the Social Investment Task Force have to say – in its easily digested short, 30 page, 5 recommendation report – to be found on www.enterprising-communities.org.uk?

Social Investment

4. So, what is Social Investment?

   (not necessarily self-evident – the Task Force discovered early on that we had a major vocabulary problem – each sector used the same words to mean different things! Hence the glossary at the back of our report – produced for us so that we could avoid speaking vigorously but meaninglessly to each other in different languages).

   - Simply: The Double Bottom Line.
   - In the report's glossary: "financial transactions intended both to achieve social objectives and to deliver financial returns to investors."
   - Clearer in diagram form: Social Investment….



Social Investments combine both the social returns that are gained by a grant-maker – with some financial returns. They are not particular to charities – also relevant to financial institutions and individuals –

- As an example – like many people in the charity sector I make a social investment through placing some of my savings with one of Triodos Bank's lower interest funds from which resources are invested in activities that are of social benefit……a social investment.
- It is not "Venture Philanthropy" – another currently in vogue term that is too often used as if it means Social Investment – it isn't as there is no financial return in venture philanthropy, only a social return; venture philanthropy is hands-on grant making when the donor gets actively involved and engaged with the beneficiary organisation: a big social return for their altruism, time and generosity but no 'double bottom line'.

Enterprising Communities: Wealth Beyond Welfare – the report of the Social Investment Task Force

5. The Task Force was a small and diverse group: a venture capitalist in the chair, a couple of business people, Geraldine Peacock and me from the voluntary sector, a journalist – and a 'virtual' member who

participated by conference phone, the former executive vice-president of a community development bank in Chicago; all working through last summer and autumn, serviced by the United Kingdom Social Investment Forum (UKSIF) with the assistance of the New Economics Foundation, the Development Trusts Association (DTA) and a couple of Treasury officials. We were asked by the Chancellor:

"to set out how entrepreneurial practices can be applied to obtain higher social and financial returns from social investment, to harness new talents and skills to address economic regeneration and to unleash new sources of private and institutional investment…" (Again I hear so what's that got to do with us here – I'm off for an early train! – well, the brief was even longer:) *"In addition, the taskforce should explore innovative roles that the voluntary sector, businesses and government could play as partners in this area."*

Under-invested Communities

6. The Task Force's starting point was that, though the UK is wealthier than ever before, poverty has become more concentrated and inequality more marked. We described the communities on which we focused our attention as "under-invested communities":
    6.1. "Under-invested communities suffer from a spiral of multiple disadvantage. Industries that were previously major employers have collapsed, leading to loss of employment, incomes, wealth and purchasing power. In such circumstances, it is often the case that private sector investment dries up and that even those financial resources available within a community are spent outside it. Confidence collapses.

6.2. “At the same time, around £3 billion a year of public regeneration funding has been poured into the UK's poorest areas. But the effect has often been confined to improvements in the physical appearance of places that, year after year, remain stuck on the UK's list of poorest neighbourhoods.

6.3. “Public funding has too often "compensated people for being poor" and done little to increase the incomes or personal assets of the people living in these areas. Public money comes in, through welfare, housing, public services and regeneration projects, but it leaks straight out of the area rather than fostering local markets and enterprise.

6.4. “For a community to thrive, it needs individuals seeking to create wealth for themselves and their families and investors seeking a financial as well as a social return. Poor communities do not have enough of either, which is why they are better described as under-invested communities”.

Task Force Recommendations

7. The Task Force recommendations that attracted the most publicity both when our report was published last autumn and when they were incorporated into the Chancellor’s recent budget were those that dealt with two incentives that we proposed could get new funds into the poorest communities:

7.1. A Community Investment Tax Credit *to encourage private investment in both not-for-profit and profit-seeking enterprises in under-invested communities; and*

7.2. A Community Development Venture Fund - *a matched funding partnership between Government on the one hand and the venture* *capital industry, entrepreneurs, institutional investors and banks on the other*.

8. We also recommended disclosure by individual banks of their lending activities in under-invested areas, and the creation of a rating system to reward excellent performance in those areas by banks.
9. And what we believe is a key to tackling the sort of poverty we described – the creation within (and by) communities of a network of Community Development Finance Initiatives (CFDIs):
    - 9.1. standing between Government, banks, individual, charitable and other investors on the one side and businesses and social and community enterprises on the other;
    - 9.2. pooling funds from different sources, funds motivated by different things – from financial institutions, individuals, charities;
    - 9.3. providing informed local assessment of new and fledgling enterprises and a mixture of grants, loans & equity + skills, mentors & training.
    - 9.4. CFDIs are a diverse range of organisations, no one prescription; some area based – some created within a community of interest: faith groups, ethnic minority groups etc.
    - 9.5. They can include Banks with social objectives (Triodos, Unity), Community Loan Funds, Micro-loan Funds - many of you may already be familiar with some of these pioneer CDFI's:
        - local organisations like the Aston Reinvestment Trust or the Merseyside Special Investment Trust;
        - Micro-credit suppliers like Street UK or the Prince's Youth Business Trust;
        - National initiatives like Investors in Society, Industrial Common Ownership Finance or the Local Investment Fund.

Charitable Funds and Social Investment

10. All these recommendations will, I believe, influence positively the environment within which charities tackling poverty and community regeneration operate. But the Task Force also argued that:

    "Currently, it is charitable to help people who are poor. However, if you want to help them out of poverty through enterprise, the odds are stacked against you. So, charity ends up as helping the poor, so long as they stay poor. It is time to change the rules."

11. We stated firmly that charitable funds and charitable action had been crucial in supporting the creation of some of the most innovative community development projects and organisations, but we found confusion and uncertainty among charities (at all levels) about "when community development finance is charitable and when programme-related investment is acceptable to the Charity Commission" – so we made a recommendation that there should be greater latitude and encouragement for charities to invest in community development initiatives.

12. In making this recommendation, we have found common cause with – and enthusiastic flexibility within – the Charity Commission; they have been at pains to confirm that (subject, of course to a charity's objects and powers being appropriately defined), it can be charitable:

    - To fund community development and to support new commercial enterprises.
    - To assist employed people when supporting the regeneration of communities.

13. We also found (as I hope the Chief Charity Commissioner may have confirmed this morning) that it was not necessarily the case that Trustees should always seek to maximise the financial return from their assets; rather, Trustees could make some investments that,

though they may produce a lower financial return than the standard components of a portfolio, do generate a significant social return as they support some aspect of the charity's objects – an investment with a double bottom line – a social investment – or, for a charity, a Programme Related Investment (PRI).

14. Both the acknowledgement that charities can assist what may be profit making activity and that PRI can be a legitimate use of some of a charity's resources and assets challenge charity finance orthodoxies – and, the latter goes well beyond the Task Force's preoccupation with community finance, small business enterprise and community development.

15. There is, however, nothing new about these two issues – the first is not another new definition of what is charitable, but a clarification of what is already OK. And the second – the use of a charity's assets to meet needs of current beneficiaries while also generating a financial return which can help future beneficiaries – has also been OK for charities which have the appropriate powers; and not just for enterprise development: Programme Related Investment can cover all charitable purposes: education, health, social services, arts – not just economic development and the relief of poverty.

Programme Related Investments – a challenge to the orthodox

16. The orthodox line has been to keep management of a charity's capital (by hard nosed investment specialists) separate from the use (by soft-hearted charitably minded liberals) of the income for charitable activity. Grow the assets as much as possible while meeting current income needs. These days, I suggest, such a crude separation makes for an increasingly flawed strategy.

17. What Social Investment and PRI can do is to provide a charity with a wider range of options for using its resources to support charitable objectives. For a grant making charity, the traditional option – and the only one that many advisers said was available – has been to… make a grant. An early illustration of the range of options that a PRI approach makes possible comes from the Ford Foundation – which has pioneered the approach in the USA: in 1968 the Foundation was assessing a grant application from a community group that wanted to provide on-the-job training for minority ethnic young people as they rehabilitated a tenement building; the Foundation's assessor realised that "the project was going to end up creating an asset that would generate revenue". It occurred to him that "maybe we could help the project with a loan, not a grant". From that very basic initial assessment came the pressure that led in 1969 to the Federal Tax Reform Act which expressly permits US foundations to use some of their assets for social purposes, to make Programme Related Investments.

18. We don't need legislation to do the same over here – we already can. Examples of possible PRI social investments by charities are:

    18.1. Recoverable grants
    18.2. Underwriting
    18.3. Interest free loans
    18.4. Hard loans for non-bankable community enterprises
    18.5. Property portfolios that prioritise Hackney not Mayfair
    18.6. Equity investment in new social business

    Charitable grants can also be a stimulant for social investment – the Social Investment Task Force, for example, highlighted the importance of grants to lever new non-charitable resources – to provide subsidy or working funds for CDFI's, for example, that can then attract much bigger sums from non-charitably motivated…

So why is PRI not already mainstream charity finance?

19. If all this already possible and not new – why is it not already part of mainstream charity finance?

    19.1. Grants are simple – for the grant maker and for the recipient charity: loans and other alternatives are complex. But that needn't be an insurmountable obstacle – after all charities and voluntary organisations have demonstrated lots of ingenuity (albeit not necessarily of their own choosing) in recent years in assembling jig-saws of different funding to support their charitable work: fees (from statutory sources and from service users), EU and regeneration funding, sales alongside donations and legacies; and Housing Associations have had to get into commercial finance on a massive scale – for half their capital funding.

    19.2. Second, the traditional investment orthodoxy is a powerful culture: maximise return – grow the capital asset as big as possible and then use the income to feed charitable spending. It may be a little harsh to say that it is in the interests of investment managers and advisers to maintain that mantra – to do otherwise involves them either in investing their own resources in hiring new specialist people or losing some of the assets they manage to Social Investment. It's also uncomfortable for understandably cautious Trustees to relax on the orthodox line: they are advised that it would be risky to set aside, say, 5% of assets for social investment: not prudent stewardship (compared with the security of equity investments that can lose that amount that in a day!!). Maybe the positive encouragement that I anticipate will be made by the Charity Commission to Trustees to look at the potential of PRI to help realise their charitable objects will get some alternatives onto the investment management agenda.

Why Bother?

20. If Social Investment and Programme Related Investment are so complex and such a challenge to all that we hold dear – why bother??

    20.1. An addition to the current armoury of methods of addressing our charitable purposes (if the Trust for which I work set aside just 5% of its assets for backing Social Investment PRI's – that's £26 million that wasn't available before to use in the current year …)

    20.2. Make charitable funds work harder – if get a return, albeit a smaller one, then those funds can be used 2 or 3 or 4 times …

    20.3. Work harder, too in deliberately tempting or making it easier for other funds to come alongside. I got some kicking within the charity world some years ago for voicing an aversion to the constant pleas from central and local government – and some lottery distributors – for funding partnerships; beware governments waving partnership was my gentle plea. Now here I am advocating partnerships – but this time the charity sector can be the stimulant: put some funds up front, or provide some of the running costs of an intermediary CDFI, then be in a position when the charitable funds can lever in much bigger money…

    20.4. Charities and voluntary organisations have different and evolving funding needs and possibilities – they are not static:

    - Organisations **Need** Different Types of Finance and Support at Different Stages of their Development…
    - Organisations are **Capable of Using** Different Types of Finance and Support at Different Stages of their Development…

- Organisations can **Generate** Different Types of Finance and Support at Different Stages of their Development

…and we need funding strategies and options which reflect that: mixtures of different resources at different times – always trying to concentrate grants where they are likely to be most critical and looking to use other types of funding wherever possible. That way the total 'pot' goes further.

21. So – I close the day with encouragement that charities look for opportunities for PRI and Social Investment – and that they be brave in the face of advisers who say it's all too complex and iffy (some of the "outside our competence" arrogant nonsense I've had put to me about Social Investment by investment managers in red braces – but not all, I'm delighted to report); and with encouragement for charities to address the complexity because it may mean that charitable funds can do more in long term – and help both today's and tomorrow's beneficiaries with the same money. Not a bad objective to end the day on.

David Carrington
17 April 2001