INVESTING FOR GOOD CONFERENCE (NSW Council of Social Service: NCOSS)
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What can we learn from the experience of the charity sector in the UK in engaging in Social Impact Investment?
The past decade has seen huge and potentially transformational growth in financing social outcomes, but how does the sector engage in this development wholly and successfully? And how do we ensure that this transformation unleashes the true potential of civil society?

INTRODUCTION

The UK has become a bewildering place – and not just because of Brexit. We are in the midst of an era of chronic economic and political uncertainty, a souring of social discourse, exacerbated social divisions. We seem to be turning inwards and there is an accelerating hysteria about 'the other', people who think differently or who have escaped to the UK from war or famine or oppression – a narrowing of attitudes matched by a loss of public generosity and openness. For many the country has become an unpleasant, even fearful place. It is also a time when the real wages of much of the working population are no better, indeed lower, than they were a decade ago, the housing shortage is bad and getting worse, social and health care are buckling under the combined pressure of reduced or frozen funding and increasing need.

For first time in my lifetime, the younger working generation is likely to be poorer than their parents at their age and, in some parts of the country, is likely to die younger than their parents.

Moreover, a lack of trust in almost every type of institution or profession has grown. Some of this has been goaded or encouraged by sections of the media which seem keen to foment divisiveness – but much of the trust deficit has been 'earned' by the blinkered vision and 'out of touch' behaviour and attitudes within professions and institutions (including, ironically, the media itself).

The charity sector has not escaped the destabilising fall in public trust. It is also struggling for other reasons – it has been prone to shooting itself in the foot with crass and insensitive fund-raising methods and has provided plenty of governance messes for the media to pick at and to ridicule.

Yet, at the same time, it is a period of much exciting, creative and entrepreneurial energy and innovation within civil society about what it can achieve and how it can do it, particularly in its use of social media and new technology, in increased collaboration across traditionally isolated sectors, in exploration of new forms of accountability, transparency and user engagement – and in a growing interest in 'investing for good', in 'doing well by doing good', an interest that crosses wealth, demographic, social and political boundaries and is built on a new attitude among some investors that seek to use their resources in ways that look beyond just financial self-interest.

THIS SESSION

My task here is to suggest some lessons learnt during the last tumultuous decade in the UK within the charity and social enterprise sectors about whether, how and when to make use of new and additional forms of "doing well by doing good" finance, loosely labelled as Social Impact Investment (SII), to extend, strengthen and make organisations more resilient. I'm delighted to take up that challenge.

A central theme of what I will say will be about the vital importance of funder behaviour to the achieving of lasting social change – the impact on the realisation of such achievements of the processes and ways of working adopted by the funders of charities and social enterprises, whether they be funders within philanthropy, the government or the private sector.

There is lots of talk about the need for the charity sector to get better at assessing and reporting the quality and impact of what it does to protect and to transform lives and communities. I think we need to see as much energy going into the examination by the funders of that work of the impact on it of their own behaviour. They need to be aware of and alert to the consequences of the ways they choose to work, their practice, their expectations and assumptions; of how their funding behaviour can, if carried out inappropriately, dilute or distort the quality and achievements of the charitable and community organisations they seek to help – that their behaviour as funders can serve and strengthen; or it can undermine and weaken.

BEWARE GENERALISATIONS

At the start of any discussion about the funding of UK civil society, of the voluntary and charity sector, it's always important to issue a health warning that generalisations should be avoided. The diversity of the sector, the different sizes, shapes, histories, aims and functions of the organisations within it – and of its funders – make most generalisations pretty empty.

However, let me immediately break that rule and make a couple of big generalisations about the funding of the sector:

1. First, beware chasing after the single magic funding wand or fund-raisers' 'holy grail'. Success in funding is usually about assembling a jig-saw of different types of funding from different types of funding source – a jig-saw, what's more, that will be made up of different pieces at different times in an organisation's growth and development.
   Sadly, too many organisations in the UK charity sector have too limited a funding base and are often chronically undercapitalised for what they are trying to do. They have neither strong enough revenue streams and/or reserves to deal with cash flow threats; nor are they well enough capitalised to invest in new developments, to explore risky but potentially promising opportunities; or

just to invest in strengthening themselves and making themselves more resilient and robust.

Their business or financing model, too often, is ‘money in-money out’ – and they are the more vulnerable and fragile because of it. No single new form of funding can cure that fundamental weakness but I do reckon that the menu of types of finance and funder is much longer than most organisations have yet sampled.

SII is an addition to that funding menu – but it is a means to an end, the end being the achievement of the charitable mission, the public benefit, that the funds are intended to help make possible. Sadly, within the UK and perhaps elsewhere, some of the hype surrounding recent developments in social investment have tended to present SII as some sort of magic new ‘holy grail’. It isn’t. It can be useful in certain situations and for certain types of project and organisation. It can bring new funds and funders into the charity sector. But it remains a means to an end, not the end itself.

2. Second – Grants are OK! I’m a champion wall spraying graffiti artist for this campaign. I despair of the assertions that we hear so often about ‘grant dependency’. Grants are an absolutely essential and completely legitimate part of the funding menu for almost every organisation at various points in its life and for specific situations and purposes. But grant finance from every source is limited and precious. If such resources are scarce, it seems self-evident that grants should only be used where no other form of funding (whether it be earned, borrowed or self-generated) can be used as effectively. Charities that need funds, and the philanthropists (or the state) that can fund them, would be wasting money if they used grants where other forms of finance could achieve the same result. The types of finance that I’m talking about, forms of social impact investing, are additional items on the funding menu – but most of them are only relevant when grant income is also judiciously and appropriately used alongside them or in advance.

THE ‘WRONG’ SORT OF MONEY

One of the main drivers of my work over several decades is illustrated by a quote used by Julia Unwin, the former head of the Joseph Rowntree Foundation, in her excellent book The Grant-Making Tango: an exasperated leader of a community based charity, speaking of foundations, complains “the trouble with many funders is that they often give you the wrong sort of money.”

The focus of my work has been to try to help ensure, first:

- that charities and other social purpose enterprises have access to ‘the right sort of money’ – appropriate to what they are trying to do, to the stage of their growth and development, and to their capacity, resilience and prospects for longer term sustainability; second

- that funders understand what is likely to be the best way of resourcing such activity – and don't just assume that making a grant towards a specific project is always the thing to do; and third and perhaps most important
- that both 'sides' of the transaction behave towards each other in ways that are most likely to achieve the results that both desire.

What the exasperated project leader that Julia Unwin quoted was talking about were funders (that include some I have worked for, sadly) that:

- expect the charities to which they make grants to achieve complex and often hugely ambitious project goals within a very limited period of grant-funded time. All involved, I suspect, in their hearts, know the funding period won't be long enough for those goals to be fully attainable;
- that tend to underfund the proposed level of work and, especially, to underfund the essential operational running costs of the organisations – without which the organisation, and the project, are vulnerable and likely to underperform;
- that adopt administrative and reporting systems which impose often futile and excessive transaction and compliance costs (on the funder as well as on the funded charity) which are fixated on counting outputs and not on understanding the nature or quality of what has been achieved, and are disproportionate to the scale of the funding; systems and processes that can add burden not value to the transaction;
- and that collude with a situation where too many organisations that are hunting for funding feel that they have to reshape their description of what they are trying to do in order to meet funder enthusiasms and criteria. This is a funders' condition (or disease) that I have called 'project-it is'. It can all too easily lead to a distortion of an applicant organisation's mission as, desperate for funding, they feel obliged to "bend too willingly in whatever direction money is blowing," an understandable tendency but one that will, ultimately, be self-defeating.

Grant makers can help build strong, reflective, resilient and effective charities and social enterprises. But they can also behave towards those they seek to help in ways that stifle, inhibit and distort. I will return to that theme later because the same sort of challenges about funder 'behaviour' can also apply to social investors.

SOCIAL IMPACT INVESTMENT (SII)

So, what do I mean by Social Impact Investment (SII)? There is a lot of sometimes rather futile semantic debate about the terms social investment and impact investment – a veritable 'Tower of Babel' of terminology and funding jargon rearing up to confuse and to mystify. For me, it's this: the investment of funds in an enterprise with the deliberate intention that those funds will help to secure clear, positive and measurable social outcomes, a public benefit, while also generating a financial return to the investor, enabling the funds to be recycled and used again to support further activities.

There are many people and organisations exploring SII – and they come in all shapes and sizes, from very different starting points and with very different expectations. The definition I used may sound straightforward, but it embraces a vast breadth (and depth) of investment activity.

SII is often pictured as a long spectrum of activity, with individual philanthropy and charitable foundations at one end and commercial and institutional finance at the other. There are SII explorers among them all approaching the middle from both ends. Each of them combines a hunt for social change and for community or public benefit or 'impact' with a focus on how a financial return can also be generated, over time, from the organisation and the activities that are the targets for the investment. They have different motives for being where they are, but they end up at some point near the middle.

Some of the funding will always be philanthropically driven – the social impact being the absolute priority and the investors, usually foundations, other charities or individual philanthropists, being willing to convert some or all of their investment to a grant if that turns out to be the price that has to be paid for the full social impact being achieved.

Other investors will be happy to get all or most of their capital back to reuse to support other initiatives but will not be worried if the investee can pay back no more than that.

Some other funds are place based, built round community shares and/or community based crowd funding, creating community owned assets financed partly from within the beneficiary community. Others, increasingly, are accessible to mass market investors: retail funds or charity bonds, for example, demonstrating that SII is not just the preserve of 'the big rich boys' or of foundation and institutional investors.

At the other end of the spectrum, where the commercial and financial institutions sit, new funds are bringing mainstream investment finance and pension funds into the fray, working in partnership with specialist intermediaries, and beginning to regard these investments as an extension of their standard portfolio – indeed as a healthy additional diversification.

Some new funds are testing financial instruments for supporting the better targeting and performance management of public service delivery through various forms of payment by results or outcomes based finance.

Some are exploring whether it is possible to develop (and fund) mission locked social purpose organisations that are privately owned.

All are part of the growing SII market, the 'Impact Economy' – and all have potential relevance to the funding of the charitable sector as they direct additional funds towards it.

There has been an explosion of interest and development in recent years, but do not assume that these forms of funding are all new. Useful lessons can be learnt from the past: in the 1840's, for example, it was what was called '5% philanthropy' that built new homes in the UK for 'The Industrious Classes', where philanthropists could invest their money for a vital social purpose while receiving a respectable financial return.

TRUSTEE RESISTANCE

When talking with charity trustees and leaders about the possible value to them of SII, I have often felt them resistant, shutting off. Ofcourse some are right to do so as social investment is absolutely not appropriate for all charities – repayable finance of any kind is only an option when an organisation (and an investor) are confident there is a future revenue stream that can be relied on.

But the resistance of trustees is more complex – it's as if debt or repayable finance is somehow not an acceptable form of funding for charitable endeavour; it's as if charity trustees are reluctant to consider the use of the same range of financing options in their charity activity that they will use in their own domestic lives.

In such discussions I have sometimes found it simpler to illustrate the possibilities on the SII menu by drawing on examples of my own personal finances.
For example:

1. I have borrowed from myself – from savings built up either for a rainy day, a crisis, a cash flow problem or as a restricted fund intended for a specific purchase: the equivalent for charities are ***Reserves***. Building up reserves is a key aspect of prudent management and long-term planning. Too many funders of charities have been very negative towards such good practice. Organisations, like people, that are reserves poor are particularly vulnerable at difficult times.
2. I have borrowed when faced with a single item beyond my immediate ability to buy – the lender (and I) banking on my earnings track record, taking the risk that I will be able to generate enough income going forward to keep myself fed and to be able to repay the debt. Sometimes I've borrowed commercially, from a bank or building society, sometimes from family who have offered more 'patient' lending – you pay such 'patient lenders' back when you can, not immediately when income streams may not necessarily be strong. The equivalent for a charity? – ***commercial loans from banks or 'patient loan finance' from foundations.***
3. Friends or family can guarantee an undertaking – when my son moved to London, for example, he needed a guarantee (from me) to persuade a landlord to let him move into his new rented room. The charity equivalent? – ***Guarantees, from Foundations or philanthropists.***
4. I've bought something jointly – say a car or some equipment – to share with others; on my own I could not afford it, but it's been possible as a joint purchase, a funding collaboration. For charities, **a *shared purchase or sharing services.***

5. I’ve looked for people to invest in an entrepreneurial plan – to go beyond a loan and, in effect, to make an equity type investment in my plan. If I fail, the money will have gone; if I succeed their financial return reflects the scale of my success. It’s ***Equity finance (or for charities, it’s more likely to be Quasi-equity).***
6. I’ve also gone for hybrid funding – a mix of subsidy and investment (just as happens in the private sector – despite the often almost religious fervour of advocates of the ‘free market’, the private sector is certainly not a subsidy or grant free area!). Like so many of my generation in London, I’ve given my children the capital sum needed for them to borrow the rest of the money needed to buy their homes – it’s hybrid funding as they have combined a gift from me, some borrowing from me, also borrowing from themselves, the mix completed with some commercial borrowing – the latter not accessible without the former being in place. For charities? ***Philanthropists or Foundations leveraging layered commercial lending.***

All of these, if applied to voluntary and community sector organisations, are forms of social investment – whether by an individual philanthropist, a foundation, a company or an investment fund (or the charity itself) – providing financial resources to achieve a social aim but with the possibility of a financial return. All are legitimate and feasible ways of adding financial resources to build new or bigger charitable activity. All exist.

THE CHALLENGE OF BLENDED VALUE INVESTMENT

The development of SII in the UK has not been easy. Some major challenges of financial institutional culture and perception have had to be tackled. SII, as my definition made clear, is all about ‘blending’ financial and social or environmental returns – valuing each equally.

That’s a big challenge to traditional western investment thinking – and to traditional philanthropy. For both, the idea of blended finance, of securing a social return deliberately while also generating a financial return, has been alien. It’s always been ‘either-or’, one-or-the-other (‘bifurcated’ is a term often used to describe that) – money is either given away to achieve a social good or it is invested to make money, it is not used to do both.

Traditionalists in philanthropy and in investment have both used the same arguments to resist the blended value proposition:

- you can’t do it because it is a breach of fiduciary duty;
- the regulators will not tolerate it;
- there is no demand for such finance;
- the investor is bound to lose money.

Within the UK, the resistance has been tough and extensive and is still routinely exhibited across both philanthropy and investment management – but every one of the objections raised has been successfully challenged:

- it is not a breach of fiduciary duty (at least in the UK – I’ll come back to that);
- the regulators will allow it;
- there is demand – from enterprises and from investors;

- there are SII opportunities that will generate financial returns at least as robust as traditional investments and others that will provide sufficient levels of financial return to meet the aspirations of particular investors seeking to 'Invest for Good'.

THE SPECIAL ROLE OF PHILANTHROPY

Philanthropic funds – both distributable funds and, for some endowed foundations, endowment assets – have been very important to the growth of SII opportunities in the UK and the social benefits they can help to secure. Foundations and individual philanthropists have made social impact investments:

- direct and via intermediaries;
- solo and in syndicates;
- they have helped start ups and they have backed well-established enterprises to grow or replicate successful activity.

There are lots of possibilities for philanthropically driven investment in charities and social enterprises.

Foundations and individual philanthropists have also demonstrated a particularly productive role in leveraged or layered investments where philanthropic funds can take a higher risk or lower financial return position and, by so doing, enable additional money to be invested in a project from mainstream investors – attracting far more money to support a particular public benefit than philanthropic funds alone could deliver.

Foundations and individual philanthropists have also played a key role in using grants to help the charity and social enterprise sectors get to grips with social investment opportunities:

- a grant to help a growing organisation establish a track record that can encourage future investment;
- a grant to evaluate and learn from experience so an organisation can improve what they do and make the case for doing more;
- a grant to learn how different types of social investment could enable them to do more or to become more resilient.

Grants that can help to build the market for social investment and to establish the necessary infrastructure, capacity and know-how.

OTHER LESSONS

Some other lessons learnt I think we have learnt about SII from the UK:

1. You Need Patient and Passionate Pioneers. Building a SII market takes time – on both sides of the transactions – as this is unfamiliar and largely untried territory. It needs passionate pioneers and champions with stamina and determination. They must not preach or prescribe – you can't force a market into existence – but they have to keep working to change the very deeply rooted cultural obstacles within charities and within the financial services sector.

And, even when the money and the infrastructure are in place, individual SII transactions take time – work leading to an actual commitment may have taken many months of preparation and negotiation; many more months may pass before money actually flows; and months, probably years, will pass before the lasting social impact of that investment can be accurately assessed.
Momentum is increasing – Big Society Capital, a source of SII for the social sector in the UK set up just 5 years ago that some of you may have heard of, has now committed over £1Billion of it and its partners funding – but the SII market is still immature and almost every transaction has been 'the first of its kind.'

2. Need for Specialist Intermediaries – small scale charities, like SMEs in the private sector – complain that they cannot engage with investors because there is a mismatch between the small scale of the funding they need and the large amounts the investors want to place. Specialist intermediaries – whether thematically specialist, geographically focused, or concentrating on a particular type of funding – can be the bridge between such supply and such demand, acting as a conduit for investors by taking in large amounts of money and then allocating it in the small amounts needed by the individual enterprises. They can also bring together funding from different investors to create syndicates which can reduce transaction costs for all. They can also use their specialist knowledge and networks to provide highly relevant advice and support to potential and actual investees. They can act as agents for philanthropic funds who want to commit funds to SII but do not want to be the 'face of the lender' who might have to call in a loan that has gone wrong. They are an essential feature of the UK scene.

3. Misconceptions about Fiduciary Duty have to be challenged. There is a tendency throughout the world for institutions and professions to work in silo's – or rigid boxes – to stay within tightly defined boundaries. SII is an absolute challenge to that – it depends on the world of investment and finance working in partnership and engaging mutually with the social enterprise and charity sectors; to replace the Binary 'Either/Or' bifurcated approach with the 'Both/And' blended approach.
We found in the UK that one essential key to unlocking these fixed positions has been a review (or perhaps a rediscovery) of what the fiduciary duty of charity trustees actually means. In the UK, orthodox definitions of fiduciary duty have been concerned solely with financial risk and return. Whether the invested funds are being used inconsistently with the values or long-term mission of the charitable investor has tended to be ignored or even dismissed as irrelevant. It has been very hard to persuade investment managers or advisors to accept that a 'blended' approach to investment could be legitimate, one that equally values financial returns with other externalities like social or environmental impact.

> We have had to work with the regulators and the law commission to get this persistent misinterpretation of fiduciary duty reviewed and clarified. And we have succeeded. The position of charity trustees in the UK is now clear. They "are obliged to use their resources in ways that best meet their charitable objectives; charity trustees are not obliged to pursue investment returns at the expense of their charitable mission, their organisation's reputation, or in ways that could alienate donors or beneficiaries."

IMPACT MEASUREMENT

The definition of SII I gave you earlier uses the phrase "the investment of funds in an enterprise with the deliberate intention that those funds will help to secure a clear, positive and measurable social outcome." Some form of impact measurement is central theme, indeed a requirement, of SII.

For many in the charity sector, demands for measurement have become a wearying mantra of often under-engaged funders – and provoked, rightly, a strong push-back. For example, Julia Unwin, in the Grant Making Tango from which I quoted earlier, says there is a danger of funders' enthusiasm for impact measurement, becoming a "frequently absurd pseudo-science, a misguided attempt to quantify the abstract, an issue that has been over-intellectualised, made too complicated and been confused with notions of numerical measurement."

And Darren Walker, head of the Ford Foundation has gone further, asserting that: "We need to stop treating grantees and partners as contract workers and project managers. Instead we need to restore balance and honesty to our interactions. We need to learn more from one another, communicate and iterate often, and adapt to the changing needs of both parties as they arise. Our sector's obsession with quantifiable impact, and frequently dogmatic adherence to discrete deliverables, undercuts the expansive purpose of civil society organisations, miniaturising them in their ambition. In other words, this system is rooted in transactional short termism – a tyranny of donors – that distorts and inhibits, rather than unleashes, the potential of civil society."

Both are right in their criticisms of the behaviour and demands of some funders – but both would be worried if people thought they were arguing that good impact measurement is not an essential feature of good management practice. Why would you want to work in (or help to fund) an organisation that was:

- unable to set out clear outcomes and performance targets which a particular function or new project is intended to deliver;
- unable to be clear in advance about the steps that it will take to achieve those targets;
- unable to take stock as each step is completed and to be ready to adjust or amend the targets/timetable/methods if experience and learning demonstrate that to do so would be appropriate?

Good, purposeful and inspirational management (and the effective use of resources) depends on such measurement being at the heart of any organisation – especially so if it is trying to address a tough social challenge or assist an underserved community.

That is not something specific to SII. It is unfortunate that, certainly in the UK, inappropriate or excessive funder demands for 'impact measurement' have tainted the data gathering and learning that ought to be a central feature of any well managed organisation.

GOVERNMENT

The involvement of government has been critical to what has been built in the UK – through legislation, tax reliefs, regulatory changes, policy initiatives, money and public leadership and encouragement. But Government action can hinder as well as help; indeed in the UK we have found they can do both at the same time – the actions of one part of government sometimes proving to be an unmovable obstacle to the aspirations of another.

Government can exhort charities to make use of SII, especially funding associated with payment by results, but if it is at the same time the source of inadequate, insecure and poorly procured funds for public services provided by charities, it is responsible for generating overstretched and fragile services for some of the most vulnerable people and communities. That discourages positive progress.

Government also finds it difficult to be patient – and SII development definitely requires patience. Government timetables tend to be short term. Government tends to rigidity and likes things to be defined, to set firm boundaries, to get anxious about flexibility, to find it easier to measure what is easy to count, not necessarily what is important to monitor.

Government can often choose to go some way in the right direction but to do so tentatively, not going far enough and not spotting (or listening to warnings about) unintended consequences.

Government behaviour can make or break the successful building of a SII market. Such a market will always be messy and untidy – littered with things that didn't work as planned, gaining much from luck and serendipity and from individual entrepreneurial brilliance that is seldom easy to emulate – that's the nature of entrepreneurial energy. SII, therefore, is a challenge to a lot of Government comfort zones.

INVESTOR BEHAVIOUR

I spoke earlier about how vital investor behaviour is to the successful outcome of the work they choose to support. Social Investor motives and intentions may be fantastic, but their behaviour towards potential or actual investee enterprises, the requirements they impose during due diligence or after investment, or the assumptions they make about how the enterprise should be managed and the actions they take as a consequence, can all weaken rather than strengthen the chances of the enterprise being successful and achieving the mutually desired purposes and outcomes.

They can often demonstrate a very basic lack of understanding of the realities of running a social purpose organisation – I have, for example, encountered bafflement and total lack of comprehension among potential investors about how staff (or trustees) can be motivated to work hard and well without the financial incentive of monster bonuses – it's just outside their world view.

Social Investors have to learn to behave constructively when they are engaging with social purpose organisations. Precisely because the investee organisations are working to achieve blended value returns, neither just a financial nor just a social return, the investors have to engage differently with them from how they would if they were making an investment driven only by financial ambition. That may sound obvious, but it's been a tough lesson for many social impact investors to learn – to avoid always behaving (and expecting investees to behave) as they would in the orthodox financial world in which they have acquired most of their previous experience.

The prescriptions that may seem obvious to a financial market driven investor may be exactly wrong for implementation within a social purpose organisation – but some of the skills and knowledge learnt in the financial sector may, if applied sensitively and after a lot of listening, 'translating' and adapting, be very helpful to social entrepreneurs trying to build financial resilience while staying firmly committed to their purpose and aspirations.

If social investors are to engage effectively with such social purpose and mission driven organisations, they have to learn to understand 'how it ticks'. The charity and social enterprise sectors, the potential investees – you – can help them avoid some of the clumsy and ill advised investor behaviour you may have read about and to learn from the consequences of the poor grant-making practice I described earlier – and then to apply those lessons to SII and, as a result, bring new and effective funds to support the charity sector and the people and communities with which they work.

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