

Response by the Social Enterprise Coalition to *Social Investment Wholesale Bank: A consultation on the functions and design*

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Introduction

The Social Enterprise Coalition (the Coalition) welcomes the opportunity to respond to the Office of the Third Sector's (OTS) consultation entitled *Social Investment Wholesale Bank: A consultation on the functions and design*.

The Coalition was established in 2002 as the national voice of social enterprise. We represent a wide range of social enterprises, umbrella bodies and networks, with a combined membership reaching over 10,500 social enterprises. These include co-operatives and mutuals, development trusts, housing associations, leisure and football supporters' trusts and Social Firms. This response was informed by consultation with members of the Coalition.

Social enterprises are businesses with primarily social or environmental objectives whose surpluses are principally reinvested for that purpose in the business or in the community, rather than being driven by the need to maximise profit for shareholders and owners.

Finance is the motor for all business development and the social enterprise sector is no different. A lack of access to appropriate finance can be a significant barrier to growth. The Coalition has been working hard to level the playing field for social enterprises looking to access finance. However many organisations still face significant barriers in securing sufficient appropriate capital.

Question 1: Do you agree with the vision for a Social Investment Wholesale Bank set out in this consultation?

1. The Coalition believes that there is a strong need for a wholesale institution and that the Government should support the creation of a Social Investment Wholesale Bank (SIWB) through the use of a portion of the unclaimed assets from dormant bank accounts.
2. We support the overall vision of a financial institution which would work in the interests of society as a whole as well as the broad objective of increasing investment in society, the environment and the economy, delivering against a 'triple bottom line' of economic, social and environmental aims. We believe that an SIWB could play a role in building up credibility, attracting more investment in social enterprise activities.
3. We note that there is likely to be a debate about where the Bank sits on the private-public sector spectrum, as this will have implications in terms of control and accountability. This issue is dealt with in our response to Question 14.
4. We have questions as to the robustness of the figures relating to dormant bank accounts, whether the banks will be prepared to give up the assets required in the present economic conditions and, if so, how much. Indeed, the scale of the Bank will influence what it is able to achieve.

Question 2: Do you agree with the economic case as it is set out, and do you have further evidence, case studies or detail in its favour, or evidence to the contrary? To what extent does the evidence suggest problems are short term (for example, linked to the immaturity of the market or perceptions) or intractable?

5. The Coalition agrees that there is an economic case for an SIWB.
6. There are a number of major barriers faced by social enterprises and areas that the Coalition believes are important to work to overcome:
 - *Availability and role of grants*
Grants are likely to remain an important part of a diverse financial mix for many social enterprises. Small grants are particularly appropriate for social enterprises that are starting up. However there is a general move away from grants, it is a competitive environment and their availability is limited.
 - *Lack of appropriate finance for growth*
The fundamental barrier that currently faces the social enterprise sector is that organisations do not find finance for growth. Part of the issue is about getting the right sort of finance, without which organisations are unable to increase the amount of social and environmental benefit that they can offer. It is from this that a number of further barriers flow.
 - *Lack of clarity about equity for social enterprise*
Most concepts of higher risk capital are structured around some form of equity. There is currently a lack of clarity about what equity for social enterprise is and what is appropriate. Some social enterprises would face difficulties in issuing shares because of the legal structure they have chosen.
 - *Social return on investment remains weak*
It is likely that social enterprises will be looking to provide potential investors with a 'blended return' including both a financial and social and/or environmental contribution. As such there is likely to be a need to represent the added 'social value' an investor receives. However currently no single standard exists, and the practice is not widespread.
 - *Some aspects of the social investment market are underdeveloped*
The social investment market refers to the scope of activity which supplies the sector with finance. As innovating businesses, social enterprises often have long pre-revenue periods in which to develop ideas into specific products or services and so require patient capital. Although some parts of the market are developing, currently the social investment market overall is under-capitalised and largely unconnected. Many successful social enterprises fall into gaps between available sources of investment, such as between loan and equity growth stages. A financial wholesaler or investment bank would be able to develop the social investment market, allow it to access the private markets and increase the supply of finance.

- *Lack of market information*
Although a number of organisations and intermediaries offer social enterprises different forms of finance, the market is fragmented. There is no clear picture of who is able to supply what, and where the gaps in provision exist.
- *Financial skill set of the sector is still underdeveloped*
There are currently particular gaps in the knowledge of many social enterprises looking to access finance. Whilst we believe the general awareness has increased, the skills required to work with larger amounts of finance and more sophisticated financial products is lacking.

Question 3: There are five potential functions for the Bank outlined in this consultation:

- **a champion for sustainable social investment;**
- **raising capital;**
- **investing and providing capital;**
- **market-making; and**
- **advisory services.**

Are these an appropriate response to best address the problems identified above? If not, why not and what are the alternatives? If so, is an SIWB an appropriate vehicle to carry these out? Would it add greater value than existing government programmes to date?

7. There is a question as to what an SIWB could realistically do, given limited resources. Although, on the face of it, these functions would likely benefit the social investment market, we question whether an SIWB could successfully carry out all these functions and there would need to be greater clarity about its core functions.
8. Social investment is a market which requires support to develop. The SIWB should aim to develop both the supply of and demand for investment within the third sector, particularly to social enterprises. It should make investments, whether equity or equity-like, use its balance sheet as a guarantee to leverage further private finance, help existing intermediaries raise further finance for investment and help develop new forms of financial products. It should also help with investment readiness and tackle the lack of investment knowledge.
9. The SIWB needs to be independent, flexible, risk taking and capable of being a market shaper. It would need to be of sufficient scale to leverage significant private sector capital. A wholesaler would be able to identify gaps across the marketplace and not be forced to oversupply specific areas.

Question 4: Each potential function will have costs and benefits over time (both direct and indirect, social and financial). What is your view about these costs and benefits, and what evidence is there to back this up?

10. The SIWB should focus on the functions it can realistically fulfill with limited resources that will yield the most social and environmental benefits whilst remaining financially viable. The

provision of advisory services, particularly to front line organisations, is likely to be costly and not straightforward for a wholesaler to manage.

Question 5: Should advisory services for frontline third sector organisations and social investment intermediaries accompany the provision of capital or be provided separately?

11. The proposal that advisory services be provided for frontline third sector organisations as well as investment intermediaries would have profound implications on limited resources, could be a mammoth undertaking, is likely to need grant funding and would necessitate operating on both a macro and micro level.
12. An SIWB would be best placed to support existing advisory services rather than create new ones. Such services can operate in different ways and act as links between the retail level and front lines.

Question 6: When raising capital, what combination of social and financial risks and returns would be attractive to investors? What evidence is there that the Bank could attract investment on these terms, from whom and through which investment products?

13. The SIWB could use a range of options to attract considerable additional investment from mainstream financial institutions that have, as yet, to engage in the social investment sector. It could co-invest into existing financial intermediaries in the sector. It could also underwrite the first losses or guarantees to mainstream organisations investing in the sector for the first time and possibly offer tax breaks.

Question 7: When providing capital, what combination of social and financial risks and returns would the Bank offer? What evidence is there that the Bank could make investments on these terms, to whom and through which investment products?

14. As we stated in response to the HM Treasury consultation *Unclaimed assets distribution: a consultation* the SIWB could make investments that carry a higher level of risk than other institutions are able to make. In order to achieve this, such an institution would need to be sufficient in size to enable it to aggregate a number of different forms of investments, allowing it to price out the risk of offering finance.

Question 8: Which combination of functions would be most effective and deliver best value for money?

15. As outlined in response to Question 5, we have questions about the viability of a wholesale bank providing advisory services on a micro level.

16. The focus should be on the Bank being a champion for sustainable social investment; raising capital; investing and providing capital; and market-making, with advisory service activity being supplied by existing providers.

Question 9: Do you agree that eligibility should be based on potential social and environmental impact, rather than defined by legal or organisational form? If so, would it be necessary to ensure that the Bank ultimately supported a diverse range of enterprises, for example small, black and minority ethnic-led and rural projects?

17. Social enterprises are businesses that trade in the market with a social purpose. As outlined in the Social Enterprise's publication *Unlocking the potential – a guide to finance for social enterprises*, a social enterprise is not defined by its legal status but by its nature: its social aims and outcomes; the basis on which its social mission is embedded in its structure and governance; and the way it uses the profits it generates through trading activities.
18. Social enterprises share a number of common characteristics: enterprise orientation, explicit social aims and many are also characterised by their social ownership. They can, however, take a variety of forms and legal structures. Many social enterprises are structured as companies limited by guarantee. Fewer social enterprises are structured as companies limited by shares. Many social enterprises have registered as Industrial and Provident Societies (IPS). Since 2005, a number of social enterprises have chosen to register as Community Interest Companies (CICs).
19. It makes sense, therefore, that eligibility is not simply defined by legal or organisational form but reflects the diversity of structures and forms that are used by social enterprises. On the other hand, it needs to be defined sufficiently by desired outcomes so as to ensure social and environmental benefit.
20. In seeking to address a range of social issues and in identifying gaps it is highly likely that the Bank would support a diverse range of enterprises in the course of its business.

Question 10: This consultation suggests that the mission of the Bank could be to create social and environmental value through increasing investment for a social or environmental purpose. How do you think the mission of the Bank should be defined?

21. The mission of the Bank should be defined in terms of achieving maximum social and environmental benefit within the given financial constraints. As we state in response to Question 14 the Board structure can facilitate this through having a mix of expertise.
22. It is essential that the mission and aims of an SIWB are not diluted and the Board would play a part in ensuring this. It is also vital that the function of a wholesaler be used to capitalise and develop the social investment market.
23. As we state in response to Question 12, it must be managed independently of government with the ability to operate commercially and distribute funds swiftly and efficiently. It is essential that the wholesaler be just that, using the expertise and diversity of existing social investors and lenders, rather than being a bank in its own right.

Question 11: Do you agree that an SIWB would need to be flexible and adaptable to address evolving issues as the market develops? How could it be ensured that the Bank would respond appropriately to the evolving market?

24. An SIWB would need to be flexible and adaptable to allow its knowledge and approach to inform its ability to react to priorities and to address evolving issues as the market develops. This would, however, need to be placed within a clear context so that aims and objectives are not diluted and the Bank does not suffer from mission-drift.
25. The benefits of an SIWB would be diminished if it were overburdened with targets and constraints. The institution must be able to make informed decisions based on current market conditions and not over-capitalise emerging markets.
26. Effective governance arrangements and clear leadership would be needed in order for the SIWB to remain true to its values whilst adapting to market developments.

Question 12: How best could the Bank be structured and owned in order to deliver its functions and meet its mission?

27. The Coalition strongly advocates a model in which the Bank is run independently of government and of existing retailers or other intermediaries in the finance market. This will help to prevent potential conflicts of interest. We believe that it would be best to avoid simply setting up another non-departmental public body and we see a strong case for setting up a new body from scratch.
28. Our concern would be that the way in which the Bank is structured and run does not cause displacement, distort the market with cheap capital or result in the exclusion of social enterprises from accessing the available resources.
29. It is important that whoever owns and runs the Bank has the relevant expertise and credentials in finance, particularly the more risky investment banking, as well as in the social and environmental fields, and that they are fully representative of the sector as a whole rather than just a segment of it.
30. The wholesaler should be an innovative, sustainable institution linked to, and with knowledge of, social enterprises, the third sector and their financial needs. It should work with existing intermediaries to build their market share and should avoid undermining their position. It should be outward-looking and be equipped to 'crowd in' mainstream capital.

Question 13: Under what circumstances could an SIWB carry out activities itself, rather than being limited to financing and offering support to others?

31. We believe that the SIWB could carry out activities itself in circumstances where it does not distort the market and where it can realistically do so. It is also important that the activities it carries out do not lead to conflicts of interest.

Question 14: Do you agree that the Bank should seek to report transparently against a ‘triple bottom line’ of social, environmental and financial value? What ideas do you have for how this could be achieved?

32. We agree that the Bank should seek to report transparently against a ‘triple bottom line’. This could be done through a Board consisting of members with social and environmental value expertise and members of the financial community working in an integrated manner to balance the objectives.
33. There are, of course, questions about who would be represented on the Board and whether all stakeholders would be involved.
34. Where the Bank gets its money from will determine to whom it reports. If the Bank is funded mainly through private channels it could be more independent and made accountable to the social investment world. This would ensure that the fund strategy would not be affected by short-term political considerations, that it would remain independent and that it could act in the best interests of social enterprises and the wider third sector.
35. The Global Reporting Initiative (GRI) is a network-based organisation that has pioneered the development of the world’s most widely used sustainability reporting framework. The Bank could achieve transparent reporting by using such a framework, which is already used by social enterprises including Triodos Bank.

Question 15: Do you agree that the Bank would not distort competition to an extent contrary to the common interest if it followed the guidelines set out in this consultation? What mechanisms could be put in place to ensure this, while still enabling the Bank to effectively carry out its mission and functions?

36. Mechanisms to ensure competition is not distorted against the common interest could include guidelines to avoid the market being flooded with cheap capital and controls and mechanisms to ensure fair distribution of finance. Established regulatory controls would play their part.

Question 16: How would you make a robust assessment of the necessary financial requirements over time of an SIWB, and what evidence is there to back this up?

37. An SIWB would have on-going financial requirements over time. There is the danger, in setting up an institution of this kind, that it might be developed in such a way that leaves it unsustainable. A plan to create the Bank should ensure that it takes a long-term view whereby it attracts additional investment whilst remaining suitably flexible to changing realities on the ground.

Question 17: The Government recognises uncertainties around the capacity and willingness of the third sector demand for finance. How could the risk of this undermining the success of the Bank be mitigated?

38. There is a risk of the market being flooded with cheap capital for which there is little demand or that it would go to inappropriate recipients. The challenge would be for the Bank to be managed effectively with a thorough assessment of the needs of social enterprises and other third sector organisations. This could include a scoping exercise to assess the demand levels and potential for growth.

Question 18: Do you agree with the principles for the design of an SIWB outlined in this consultation?

39. Overall, we agree with the principles for the design of an SIWB with the caveats outlined in this response.

Social Enterprise Coalition
Policy Team
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