

**Response by the Social Enterprise Coalition to the joint  
HM Treasury and Cabinet Office review of the Future Role of the  
Third Sector in Social and Economic Regeneration**

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## Introduction

Social enterprise is a business model which holds out the prospect of a greater equity of economic power and a more sustainable society – of combining market efficiency with social and environmental justice. Social enterprises are motivated by social and/or environmental purposes, rather than the pursuit of profit for external distribution. As businesses, they are independent from the state and must be efficient to compete in the market. Social enterprise is more than a sub-group or activity of the third sector: it can emerge out of the private and public sectors too.

The Social Enterprise Coalition was established in 2003 as the national voice of social enterprise. We provide a platform to showcase the benefits of social enterprise, share best practice and influence policy. We represent a wide range of social enterprises, umbrella bodies and networks, with a combined membership reach of over 10,500 social enterprises. These include co-operatives and mutuals, development trusts, housing associations, leisure and football supporters' trusts, Social Firms and other social businesses. While some social enterprises are large, the majority are small and medium-sized enterprises.

Recent estimates by the Government suggest there are over 55,000 social enterprises with employees in the UK, with a combined turnover of £27bn a year and contributing £8.4bn to annual GDP. The Government's strategy *Social Enterprise: A Strategy for Success*, published in 2002, recognised the distinct role of social enterprise in creating a strong, sustainable and socially inclusive economy. It stated that social enterprise should be firmly embedded in the business landscape, widely understood and valued. This will be a test for the social enterprise action plan of the Cabinet Office later this year.

The Social Enterprise Coalition welcomes the creation of the Office for Charity and Third Sector Finance in HM Treasury and the Office of the Third Sector in the Cabinet Office, and the current review into the future role of the third sector in social and economic regeneration. We particularly welcome the breadth of the review and believe it represents an important opportunity for social enterprise to influence the Government's priorities and spending decisions over the next 5-10 years.

Our response has been informed by consultation events, electronic consultation with our members and other strands of our public policy work. We have participated in all of the nine regional events run by HM Treasury and the Cabinet Office to inform the review, and actively supported a national event on social enterprise. It has also been informed by the consultation work we undertook in 2005 in preparing our *Manifesto*, which sets out some of the key areas of government policy in which we are lobbying for change.

The Social Enterprise Coalition is concerned that policies arising from the review genuinely reflect the diverse needs and interests of social enterprises. While many of our members will be sending individual responses to the review, this response attempts to identify the policy measures that would make a real difference to social enterprise as a whole. It concentrates on themes of particular importance to social enterprise and puts forward a range of specific recommendations, many of which are relevant to other themes in the review.

A long-term strategy is required to encourage, support and fully realise the contribution of social enterprise. We believe the government should develop, co-ordinate and embed policies on social enterprise in all sectors in the economy and all spheres of government. This will require conceptualising social enterprise in its own terms and building an evidence base on the complexity and distinct value of social enterprise.

## **Enterprise and innovation**

Social enterprises are making a distinct contribution toward more sustainable forms of economic growth in many areas of services, manufacturing and agriculture, within the context of global challenges. They are providing innovative, people-centred solutions to the challenges of social and environmental change. They are challenging the conventions of capitalist markets and the practices of private business. And they are playing an important role in constructing a more diverse and resilient economy.

We believe the Office for the Third Sector should provide an enabling and supportive environment for social enterprise – and champion the movement. Working with HM Treasury, it should build on work by the Department of Trade and Industry's Small Business Service to evaluate the distinct contribution of social enterprise in the economy and incorporate social enterprise into all strands of business policy. This includes further integrating social enterprise into the policies, corporate plans and work streams of all government departments, in particular the Department of Trade and Industry and the Regional Development Agencies

The global challenges of modern society have fundamental and far-reaching implications, requiring innovative policy responses, the co-ordination of activity across departmental boundaries and sustained investment in key areas. Social enterprises are already providing solutions in many areas, but need recognition and support to fully realise their potential. In setting the department allocations and Public Service Agreement targets for 2008-11, we believe the Government should encourage all departments to review the contribution and potential role of social enterprise.

We believe there should be more recognition and incentives for social enterprises that deliver significant public benefit. This would help to promote social enterprise and provide the right signals to business about social responsibility, while correcting the current financial disadvantage facing social enterprises that do not have charitable status. We urge the Government to review to what degree social enterprises are able to access tax incentive schemes for business and charities and, where necessary, explore ways of ensuring better access for social enterprises to appropriate schemes.

The Government could take a range of steps to encourage a greater level of promotion and shared learning among social enterprises, and potentially between social enterprises and the public sector. Such work could link to wider efforts to attract a groundswell of new entrants with the drive and ability to start up, manage or in other ways contribute to social enterprises.

### **Recommendations**

1. Embed and mainstream social enterprise in business policy and encourage all government departments to review the contribution and potential role of social enterprise
2. Encourage a greater level of promotion and shared learning among social enterprises
3. Reduce bureaucratic burdens placed on businesses, for example, by integrating Pay As You Earn (PAYE) and National Insurance (NI) schemes
4. Consider providing a dedicated innovation fund for social enterprise

## **Business Support**

Changes in the business support landscape in England will have a significant impact on the development of social enterprises, in particular regional consolidation of business support (Regional Development Agency responsibility for Business Links), as well as the move to an Information, Diagnostic and Brokerage (IDB) model for publicly funded business support.

Mainstream funding for business support is also changing. In the past, specialist business support for social enterprises has been funded through a variety of programmes, for example the Phoenix Fund, ERDF, ESF, and SRB. Many of these funds are now closing and this, coupled with the regional changes, leads to a growing concern about the availability of appropriate, high quality and readily accessible business support in the future.

The primary driver for social enterprises is a social and/or environmental impact which differentiates their support needs from that of mainstream business where the driver is profit. Though most social enterprises are small businesses, many have distinct characteristics, for example in management, finance, legal and governance structures as well as marketing. As a result, social enterprises typically develop long term relationships with advisors. Additionally, evidence shows that many social enterprises at pre-start stages are unlikely to identify themselves as businesses and are therefore less likely to approach business support agencies.

Research by Social Enterprise Coalition partners has shown that social enterprise leaders and managers need specific skills supplementary to the standard business skills required by small firms. These are now reflected in National Occupational Standards for social enterprise: (i) accountability to a wider range of stakeholders to balance social and economic objectives; (ii) working with a Board of Directors; and (iii) measuring social impact.

Given the additional business characteristics of social enterprises there are a number of barriers that are experienced in accessing support including:

- The limited and/or uneven provision of appropriate support services
- The lack of understanding by mainstream business support advisors of characteristics (and business solutions) unique to social enterprise
- Difficulty in identifying advisors with specialist social enterprise knowledge
- Inability of small/start up organisations to pay for business support services (social enterprise advice has been historically paid for by regeneration funding)
- Difficulty in seeking out appropriate finance packages (often a mixture of grant and loans)
- Confusion over business support entitlement to address the wide range of business support needs (due to the different drivers, motivations, legal forms etc.)
- Lack of awareness of social enterprise culture – either the business terminology or the social drivers

Research undertaken by infrastructure support organisations indicates there is a need for specialist social enterprise support because of the distinct needs that mainstream business support (provided in England by Business Link) does not adequately meet. Until

now, social enterprises have mostly relied on specialist providers. In addition, social enterprises in rural and urban areas have different support needs and some may also need to tap into community development expertise.

### **Recommendations**

1. Ensure sufficient resources are allocated for specialist business support services for social enterprises (including out-reach) as well as appropriate means of delivery
2. Develop and build on existing diagnostic tools to ensure that they can meet the needs of social enterprise (some regions are already doing this and diagnostics could be adapted, adjusted and tailored to meet the needs of other regions)
3. Develop and apply consistent quality standards to the information and diagnostic process (there needs to be a national resource to develop these)
4. Ensure that all publicity and information materials (including websites) are 'social enterprise proofed' for mainstream business support
5. Devote extra time and resources into learning the lessons from the Phoenix Fund
6. Further develop business advisor (and organisational) quality standards using national resources
7. Develop sector specific targets, for example market penetration and GVA plus (taking into account the triple bottom line), where these do not currently exist
8. Develop local, sub-regional and regional business support services with specialist sector representatives
9. Clarification is needed on the Government's business support simplification agenda (simplification is welcomed; homogenisation or monopoly will mitigate against social enterprise and a diverse business community)
10. Ensure a coherent approach across all business support activities (i.e. RDA led as well as Local Authority and Lottery schemes) and Business Link funded services

### **Responding to customer need**

To enable social enterprises to access the best advice and support, the service must be responsive and integrated into mainstream options. We believe this can only be achieved through the creation of a hybrid social enterprise service that links mainstream providers with specialist providers in a more effective and systematic way. IDB and support services configured in this way have been developed in both the East Midlands and are being piloted in the South West of England.

By creating a social enterprise gateway which can be approached from many different outlets, i.e. agencies that social enterprises currently go to for support, social enterprises will experience a common and co-ordinated approach to information. This may include information on mainstream support services for which they could be eligible (for example rural) before referral to specialists that can deliver the diagnostic and if necessary broker on to other specialists for further support. Each region should be encouraged to develop its own version of this approach.

Putting resources with customers, for example vouchers or bursaries, will also mean that the social enterprises can use the organisations that work best for them.

### **Recommendations**

1. Each region should be encouraged to develop its own version of the hybrid approach that links mainstream providers with specialist providers

2. Subsidised support should be available for social enterprises at start up stage, funded by RDAs and other funding streams. Subsidised support for more established social enterprises may also be appropriate in some cases

### **Infrastructure**

Infrastructure organisations for social enterprise are an important point of referral for Business Links and other agencies, providing guidance, business diagnostic, access to feasibility and project development funds, peer mentoring and other schemes. They also facilitate networks of inter-practitioner contact and skills exchange. With demand growing for social enterprise support, we believe the Government should take a more co-ordinated approach to ensure the continued work of existing specialist providers.

### **Recommendations**

1. Ensure appropriate levels of, and co-ordinated funding for, specialist support infrastructure for social enterprise
2. Encourage schemes such as Capacitybuilders to signpost social enterprises emerging from the voluntary and community sector to existing specialist business support providers
3. Where business support for social enterprise is to be provided by central government departments, consult with social enterprise networks at national, regional and sub-regional levels
4. Draw on the expertise of regional social enterprise networks as partners in the development of regional strategies for specialist social enterprise support

The Social Enterprise Coalition has also written a policy paper on business support which sets out in more detail the arguments and requirements for appropriate, high quality and readily accessible support. We are also a member of the Enterprise for All Coalition which recently published a research paper, 'Enterprise for all: progressing the agenda', which looks at the current policy context, the economic and social case for 'enterprise for all' and why and how government should be involved. Business support is at the heart of the Enterprise for All agenda. Please contact us if you would like copies of these documents.

### **Education**

We believe that social enterprise should be incorporated into the schools' curriculum, mainstreamed by careers advice services and further integrated into business schools and universities. There should also be further dialogue with the Learning and Skills Council and the Sector Skills Development Agency on the best way for these bodies to support a skills development for social enterprises and other third sector organisations.

### **Recommendation**

1. Commit to incorporating social enterprise into the mainstream education and skills support systems

## **Shaping and delivering public services**

We believe that social enterprises have a demonstrable ability to improve service delivery given their strengths in innovation and empowerment, and their emphasis on combining quality services with value for money for the taxpayer. Profits and efficiency savings are predominantly retained and reinvested in the social and/or environmental purposes of the business. Other key defining characteristics include: a strong drive for financial autonomy; a flexible, non-bureaucratic way of working; and a willingness to take risks and adapt to changing need.

Social enterprises often have a close understanding of and commitment to their client groups, including people from disadvantaged communities. In addition, their customers, employees and other stakeholders are frequently involved in governance of the enterprise or engaged in the design and delivery of the services the business provides.

The Government is committed to reforming public services to improve quality standards, better meet individuals' needs and improve cost efficiency for the taxpayer. It believes that increasing diversity in the provision of public services will be the key to realising such improvements. We believe that social enterprise provides a powerful vehicle for delivering service enhancements and that a truly diverse provider market is one that involves a genuine mix of public, private and third sector provision.

To maximise social enterprise's contribution the government will need to become increasingly oriented towards outcomes and impacts, take advantage of joined up solutions, and have a more proportionate attitude to risk. Further, while competition is a critical component of a functioning market, the nature of the competition is paramount. A narrow approach should be avoided and partnership working should be encouraged, where appropriate. We urge the Government to explore models of co-production, in which a range of stakeholders are involved much earlier and more fully in the design, review and development of public services.

### **Procurement**

Real and sustained improvements in the procurement of public services will only be achieved by engaging in intelligent commissioning from a sufficiently active and diverse supplier base. Too often social enterprises are forced to compete on an uneven playing field by the failure of the market to take account of the benefits they provide.

Consideration should be given to pursuing a cultural change programme in public sector commissioning to ensure that all those involved in commissioning and procurement are supported to understand the links between their work and the wider policy of their organisation/the public sector. Commissioners should be incentivised for meeting multiple objectives with the same expenditure and joining up different types of services for efficiency gains. The result would be quality services that represent best value for the taxpayer when looked at as a whole.

A side effect of such an arrangement could be the growth and development of social enterprise suppliers with a strong track record in designing joined up services that deliver multiple outcomes across a wider range of objectives, rather than a traditional, narrower approach to service delivery. The Government should assist in this process by taking the

lead on developing robust but practical methodologies to assess economic and social impacts, building on the experience of the sector, and working to ensure widespread use and acceptance by public bodies.

Another important consideration in any move towards intelligent commissioning is the impact of the Efficiency Review led by Sir Peter Gershon, which has led to some blunt responses in the name of efficiency. Whilst savings have no doubt been made, the overall climate for intelligent commissioning has not been improved. The ability of social enterprises to deliver on the sustainable procurement agenda, as highlighted by the sustainable procurement taskforce, will be difficult to achieve unless the perception that better outcomes cost the taxpayer more is tackled at the highest level within government and a popular redefinition of efficiency made.

Another consequence of the Review has been a trend towards ever-larger public service contracts. In general, the size of a contract should be determined both by demand for the service and a proper assessment of the supplier base. Similarly, the length of the contract should be determined by the service needs of users and the need to balance market stability and scope for improvement. Further, encouraging public authorities to recognise and accept appropriate levels of risk – and to apply the same principles to all providers – would also contribute to promoting innovation and enabling more social enterprises to get involved in public service delivery. In addition, service delivery opportunities should be advertised far enough in advance and in a way that makes them accessible to all social enterprises, including those that are local, small and specialist.

We believe that if the definition of value for money is properly implemented, social enterprises will have plenty of scope to compete, but its application tends to favour price above quality and user need. Longer term interests may be more readily met through the concept of 'invest to save', which focuses the mind on the long-term rather than the current style of efficiency which has tended to focus on the short term. Unfortunately the Invest to Save programme is currently a project-based activity, too marginal to have much influence on attitudes to the procurement of public services.

In the particular case of local authorities, we are concerned that not enough has been done to enable authorities to understand, and make appropriate use of the 'wellbeing power'. This could be achieved by funding a dedicated advisory scheme on wellbeing, to which authorities could bid for specialist support. Subject to demand, the scheme could also provide advice on contracting with social enterprises and other third sector organisations, building on the achievements of the local authority Third Sector Procurement Pathfinders.

### **Recommendations**

1. Consider the provision of training and/or advisory schemes to ensure that commissioners and procurers understand the wider social environmental and economic impacts of their decisions, can take advantage of innovative ideas and understand social enterprises
2. Require public bodies to develop a purchasing strategy that makes the link to their wider policy objectives

3. Improve the emphasis on social and environmental impacts/outcomes in the intelligent commissioning of public services, within existing frameworks like Value for Money and Wellbeing
4. Develop clear guidance on the Gershon principles of public service efficiency and take practical steps to reverse the trend for ever-larger public service contracts

### **Social enterprises emerging from the public sector**

Social enterprise models have emerged from the public sector in a number of areas, including housing, social care and leisure services. At their best, such models demonstrate how efficiency can be improved without sacrificing service levels or employee conditions, with former public sector employees given more autonomy and greater opportunities to innovate.

Where appropriate, the Government should support social enterprises to emerge from the public sector by raising awareness of social enterprise models and promoting their uptake, addressing barriers to the creation of new enterprises, and providing appropriate support for groups considering new approaches. Specifically, whenever a proposal is made to externalise functions and expertise in the public sector, there should be a requirement on decision-makers to consider a range of social enterprise models.

### **Recommendations**

1. Require public bodies to consider and consult stakeholders on a range of social enterprise models for delivery whenever they are considering options for services currently provided in-house
2. Provide adequate development funds and support for public sector professionals developing new social enterprise models for public service delivery

### **Partnership working**

Entrepreneurs and managers of social enterprises are often adept at building contacts, networks, teams and partnerships. We believe the blurring of boundaries between the private, public and voluntary sectors reflects a growing trend for, and provides new opportunities for, partnership working. Effective partnerships can reduce the duplication of resources, broaden reach and enable growth.

We believe partnership working must be mutually beneficial. It should be encouraged where appropriate, but never specified by public agencies. Areas in which partnership working might be usefully supported by the Government include the joining up of networks for particular interest groups in social enterprise, cross-sectoral leadership and skills programmes on social entrepreneurship, and the development of partnerships between social and private enterprises.

## **Cohesive communities**

### **Regeneration**

In many deprived areas of Britain, there is a higher proportion of social enterprises, compared to private sector businesses. Social enterprise can help to stimulate local economic renewal by having a local sourcing policy. They can play an active role in community cohesion and in building social capital. They often play a significant role in a people-centred approach to regeneration, which puts communities in control.

Some social enterprises may require access to a wide range of financial products, including grant funding, to sustain and develop their services. Current grant regimes are rarely designed to help community organisations develop into robust social enterprises. Few are intended to fund a package of organisational development. Nor do they specifically encourage the development of more entrepreneurial approaches, such as requiring organisations to lever in loan finance or improve business processes. Opportunities may therefore be lost.

Social enterprises would rather not be grant dependent. We would like to see a shift away from grant making and toward social investment in regeneration. This means away from spending large amounts of money through short term regeneration programmes and towards investment in creating community-led social enterprises, which can play a long-term role in regeneration. This requires a different set of skills, confidence and ability to take calculated risks among public sector officials, including a greater emphasis on outcomes and community benefit.

There are many community-based social enterprises with a track record of owning and managing community assets. Owning an asset base can be a crucial factor in empowering local communities and paving the way for regeneration by providing a long-term foundation for enterprise. It can enable social enterprises to enhance social capital and civic engagement in a community, sustain the delivery of local facilities and services, while continually re-investing earned income into projects of community benefit.

We welcome the Government's moves to devolve power to the neighbourhood level and believe a renewed commitment to the acquisition of buildings and land into social ownership would support this strategy. The acquisition of public assets by social enterprises could clearly expand now that a permanent asset lock is available in such legal forms as the registered Charity, Community Interest Company and the Industrial and Provident Society for the Benefit of the Community. Social enterprises would require both funding and support to do this.

### **Recommendations**

1. Develop governing principles for community investment in regeneration
2. Consider options for the acquisition of public assets by community-based social enterprises, perhaps modelled on the Land Reform (Scotland) Act for rural and urban communities across the whole of the United Kingdom
3. Provide investment and support to enable community-based social enterprises to acquire public (and private) assets
4. Allocate a proportion of land in regeneration areas for community ownership

### **Labour market integration**

The specific purpose of many social enterprises is to create training and employment opportunities for socially excluded groups. They help them to establish an independent and sustainable lifestyle, building their confidence and self-esteem in holding down a job and taking responsibility for their lives. We believe it is important that social enterprises, as employers, are recognised as taking risks in creating paid work for those who otherwise would find it hard to secure an interview or job offer.

We support the Government's use of tax breaks for business to achieve social and/or environmental goals, as evidenced by interventions on energy and resource use. Another area requiring urgent attention by the Government is improving the incentives for voluntary and paid employment to encourage people to raise themselves out of poverty and dependency. The end result should be to get people who have been long-term unemployed into paid work, trained and mobile in the labour market.

The Government has recognised the need for Welfare Reform, but the Green Paper issued in January 2006 focused purely on vacancies within the open labour market without reference to social enterprise or the employment creation role that such models could play in meeting particular targets, such as getting one million people off incapacity benefits and into employment within 10 years.

We believe measures are required on both the demand and supply side, with an integrated review of the tax and welfare systems to reduce dependency and provide greater incentives for people to engage in voluntary and paid work and offering financial incentives to businesses that take affirmative action in providing employment and training for the long-term unemployed. The intervention would support the social and economic imperatives of labour market integration, while making a real difference to social enterprises.

### **Recommendations**

1. Conduct a national review into the economic savings and wider social impacts that are made by social enterprises moving people off welfare benefits and into the labour market
2. Consider rewarding businesses that take affirmative action in providing employment and training for the long-term unemployed and people with disabilities, while providing greater incentives for people to enter the labour market
3. Extend the earnings disregard (perhaps by abolishing the ceiling completely) to enable more people to engage in paid employment on a supported permitted basis up to 16 hours per week, at or above minimum wage levels
4. Pilot a tax credit starter scheme to enable people to overcome existing financial disincentives to paid employment, particularly in setting up social enterprises

## **Creating a sustainable resource base**

We believe the creation and scaling up of social enterprises has been constrained by a lack of access to appropriate types and levels of finance. We believe there is a latent demand for patient finance at the start-up or expansion stage in a social enterprise, in which investors are willing to accept a lower financial return and a longer pay-back period in exchange for a social return on investment. The Government has taken steps to improve the legal forms for social enterprise to make it easier for them to attract finance. But we believe that more support in this area is required.

We believe two key issues should be considered when looking at the tax position of organisations that engage in social enterprise. The first is the desire to encourage investment in social enterprise – to provide capital resources for investment in property, plant and equipment, business development and working capital. The second issue is one of equity – whether it is appropriate to tax the profits earned by social enterprise activity, where such profits are used to further social and/or environmental benefit purposes rather than distributed to external shareholders.

### **Social investment**

Social investment involves a balance of financial and social and/or environmental returns. Although the Government has established various tax incentives to encourage investment in geographically defined areas or particular types of activity, these are of variable accessibility and benefit to social enterprises. Higher levels of social investment could be encouraged by providing appropriate tax incentives to encourage investment in social enterprises and having mechanisms to connect social investors to social enterprises.

Schemes that allow tax relief at the time of investment are particularly attractive to investors. The Enterprise Investment Scheme (EIS) allows the cost of an investment to be deducted from taxable income, but is aimed at investors who want to maximise their profits. Enterprise Capital Funds have the same objective. We believe the Government should take account of recent research by Triodos Bank, which indicates the primary concern of social investors is to guarantee their invested capital, and consider how existing schemes could work more effectively for social investment.

Furthermore, we encourage the Government to consider extending EIS to include investments in bonds and other debt instruments issued by social enterprises. A similar argument could be made for Venture Capital Trusts (VCTs), which also qualify for relief. It should be noted, however, that such arrangements will not benefit social enterprises with locked assets.

Whereas tax relief schemes available to investors in VCTs and through EIS are attractive to high net worth individuals, for many the only form of tax effective saving and investment might be through an ISA. We believe that products eligible for ISA relief could be relatively easily packaged by finance institutions to facilitate investment in social enterprises, although this may require some broadening of ISA legislation. Such funds could be an ideal match for capital investment in the form of securitised debt arising from the acquisition of property and operating assets by social enterprises.

Community Interest Companies (CICs) are only able to raise investment by means of debt, equity or other non-equity share investments and charities are only able to raise investment by debt finance. A particularly effective way of increasing investment in social enterprises of this type would be to reduce tax liabilities in proportion to the sum invested and enable investors to earn dividends and interest tax free. To this end, we urge the Government to consider extending CITR to include direct investment in asset-locked social enterprises and tax relief for all dividends and interest paid by CICs from income tax.

Many social enterprises will want to invest in property or secure finance to buy larger premises at some stage in their development. Research by the London Social Economy Taskforce indicates that many social enterprises may find it difficult to secure finance for this purpose without a guarantee of financial growth. The Government could help social enterprises overcome this problem by relaxing the current EIS restriction on investing in property and/or extending Community Investment Tax Relief (CITR) to lending on property.

We believe the various capital tax reliefs available for investments in trading enterprises should be reviewed to ensure that investors in social enterprises are not disadvantaged. This could take the form of categorising social investment as investment in qualifying trading activity. Other reliefs that should be reviewed include Stamp Duty Land Tax relief for social investment in land and property and Real Estate Investment Trusts (REITs). The Government should also consider how the Small Business Loan Guarantee scheme could work harder for social enterprise.

Based on the proposals of the Bank of England report 2003, we believe that work should be taken forward to connect social angels with social enterprises requiring investment, in the manner of business angel networks for traditional venture capital. Philanthropy UK's overview of giving characterises a new breed of philanthropist as young, self-made and socially conscious. The Government could help develop a market for social investment by addressing the current lack of information mechanisms that link investors with social enterprises.

### **Recommendations**

1. Relax the current EIS restriction on investing in property and/or extending CITR to lending on property and/or consider ways of extending EIS and VCTs
2. Enable products eligible for ISA relief to be packaged by finance institutions to facilitate investment in social enterprises
3. Review the role of CDFIs in relation to social enterprise and extend CITR to include direct investment in asset-locked social enterprises, relief of all dividends and interest paid by CICs from income tax
4. Consider how the Enterprise Investment Scheme and Enterprise Capital Funds could be adapted for social investors
5. Undertake work to connect social angels with social enterprises requiring investment

### **Finance institutions**

We urge the Government to review the role of CDFIs in supporting social enterprise and how they could be become more sustainable. CDFIs must be able to operate effectively at scale and have the capacity to promote and market social investment opportunities

(such as CITR) to individual investors. It may be that the original vision for CDFIs based on community investment in the US could be usefully reviewed.

We are interested in how the £2.4bn equity base lying unclaimed in Britain's banks and savings institutions could be invested in social enterprises. We are consulting our members on the idea of a national social enterprise bank to provide innovative forms of high-value risk finance – either directly or by brokering deals with other finance providers. It would need to be independent and add value to the existing market of specialist finance. It could also help to improve the coverage of CDFIs and refinance their loan books to extend lending capacity.

### **Recommendations**

1. Explore the demand for, and potential role of, a national social enterprise investment bank to provide finance combining investment, grants and equity
2. Improve access to feasibility, investment readiness and start-up grants for social enterprises
3. Work towards a social/environmental stock market for the growing market for ethical investment
4. Produce an annual report on social enterprise finance

### **Earned profits**

We believe that the tax regime is not even-handed in taxing the business profits of social enterprises used to further social and/or environmental purposes. Under the current system, charities engaging in social enterprise (whether "primary purpose" trading by the charity or commercial trading through a subsidiary) have a competitive advantage over organisations working for community benefit without charitable status. While social enterprises can legitimately find ways of shielding business profits to be used for public benefit from tax, this frustrates the benefits of avoiding charity status.

We fully support the taxation of earned profits that are distributed to external shareholders. Where we believe the tax system is disproportionate and must be reviewed is in relation to the taxing of profits that are locked into a social enterprise in perpetuity for social and/or environmental purposes. In social enterprises of this kind, the owners and/or shareholders sacrifice any prospect at making any significant capital return. This kind of asset lock is legally required of a CIC.

Under the current tax system, providing that a business spends all of its income in its accounting year and does not purchase assets which do not qualify for tax relief, none of its earned profits will be taxed. However, tax charges may arise if an organisation:

- generates profits it wants to hold over to future years for the benefit of the community
- generates profits it wants to retain as savings toward a future purchase of community assets
- achieves its social aims through expenditure which cannot be offset against its income in arriving at taxable profit

- acquires community benefit assets which are not eligible for capital allowances for tax purposes

We are concerned that this may encourage inefficient and distorting behaviour in social enterprises working for community benefit, such as corporate structuring and the bringing forward of expenditure.

What is required is a mechanism to provide appropriate tax relief for social enterprise activity, while avoiding anti-competitive advantages and state aid restrictions. We propose a mechanism that would not tax any profits used, or put aside to be used, to further the social and/or environmental purposes of a social enterprise. The system should be accompanied by appropriate controls to ensure that any profits distributed, or intended to be distributed, to external shareholders or paid as excessive remuneration to employees are taxed.

### **Recommendations**

1. Conduct a review into tax relief on the profits earned by regulated social enterprises which are used to further social and/or environmental purposes

### **Capacity building**

The Government should support work to spread know how about the business models and financial instruments that are being successfully used by social enterprises, and allocate resources for boosting the investment readiness of social enterprises. In addition, support should be given to develop the knowledge and expertise of managers and the boards of social enterprises to ensure that risk is managed appropriately and investors get the best possible combination of financial, social and environmental returns.

### **Conclusion**

We look forward to working with HM Treasury and the Cabinet Office in formulating the outcomes from this review, ensuring its implementation makes a real difference for social enterprises and helping to improve their relationships with the government.

SEC Policy Team  
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