Acknowledgements

This report was prepared for Social Enterprise UK by Dan Gregory with support from Charlotte Chung, Ruty Geva and Nick Temple.

We would like to thank the people who gave their time, insight and expertise to support the creation of this report, particularly Ed Siegel, Scott Darraugh, Andrew Laird, Julie McEver, Simon Evill, Jo Lyons, Chris Loftus and Fergus Lyon.

We would also like to thank the social enterprise staff that took time out of busy schedules to take part in this research, particularly Accelerate CIC, Bevan Healthcare, Care Plus, Central Essex Community Services, City Health Care Partnership CIC, Community Dental Services, Enable2, Locala Community Partnerships, NAViGO, Plymouth Community Healthcare, Social adVentures, Spectrum Community Health CIC and Spiral Health CIC.

Designed by The Champion Agency, a social enterprise.
June 2013
© Social adVentures on behalf of the health and social care spin-out network
Contents

Foreword ................................................................. 4
Introduction ............................................................... 5
The Story ................................................................. 6
The Evidence ............................................................. 14
Conclusions .............................................................. 19
Recommendations ....................................................... 21
Over the past few years, there has been increasing interest in both the idea of social investment and the phenomenon of public service ‘spin-outs’ and mutuals. Meanwhile, almost unheralded, a new breed of organisations have emerged from Primary Care Trusts and other parts of an evolving public sector, hiving ourselves off as independent social enterprises. We are delivering community health, mental health, public health and social care services worth almost a billion pounds per year, often with significant multi-year contracts.

Some of us identify ourselves as mutuals, some as employee-owned businesses, and some of us have developed models of service user or community ownership. Some of us have emerged very recently, while others have now been trading for a number of years. We have grown, we continue to grow and we are ambitious for the future. We are winning contracts and we all share the aspiration to improve what we do, making a greater social impact every year.

So this research is the first real attempt to get to grips with our specific finance needs, based on evidence and stories from the spin-outs ourselves and delivered by our friends at Social Enterprise UK. The report is based on hard evidence, both qualitative and quantitative.

In fact, finance up to this point has not in reality been our most pressing challenge - some of us have no immediate need to raise external finance (as we have reserves, payment in advance or other ways to finance our plans). But for many others it may be crucial to our success, or is becoming increasingly so. By the standards of the social enterprise sector more widely, we are perhaps fortunate to have a relative degree of certainty to our income streams. Nonetheless, as with any growing business sector, we have particular challenges in building up our balance sheets and asset base from a standing start. Alongside this, changes in contract arrangements and requirements of our NHS or Local Authority partners have posed a number of nuanced financial challenges.

We are diverse sector in size and scope, so while some of us may be looking for just a few tens of thousands of pounds, others may be seeking many millions. But in all cases, of course, the terms and the cost of capital is crucial. Grants have played an important role in our early development and we don’t yet have extensive experience of debt or equity. But we are curious about community share issues, peer-to-peer models or emerging hybrid forms of finance. Some of us are already finding answers, and sometimes in unexpected places.

We know we can’t afford to bumble aimlessly into the future. So we have joined together to assess our collective position, describe the landscape around us and understand where we might find sources of investment which suit our needs. We are determined to make a real difference for our communities and we know that this requires resourcefulness, collaboration and co-operation. We hope this report can start to show the way.

Scott Darraugh, Chief Executive, Social adVentures
On behalf of the network of health and social care spin-out social enterprises
Introduction

Aim

The aim of this report is twofold:

- first, to increase understanding of the finance needs of the health and social care spin-out social enterprises.
- second, to prompt the development of appropriate investment solutions to address those needs.

Who are these spin-outs?

The Transition Institute describe a ‘spin-out’ as “an organisation that has transitioned out of a public sector body to become an independent public service provider, often under an initial contract with their parent authority. The term public service (or public sector) mutual has come to refer to spin-outs which embody characteristics of mutual or social enterprises, employee-owned or employee-led businesses, co-operatives, or some or all of the above in combination.”

There have been several waves of social enterprise spin-outs delivering health and social care in recent years. By the end of 2011, the value of public services delivered by dozens of NHS ‘spin outs’ was £886m, or 12% of the annual turnover of the social enterprise sector in the UK. Others continue to follow the path forged by these pioneers.

Methodology

This report explores both qualitative and quantitative evidence of the investment needs of this group of businesses; which solutions already exist to meet these needs; identifies gaps; and explores potential new solutions with practical recommendations.

Around the same time as the development of this report, the Boston Consulting Group undertook a related piece of research, looking at a wider group of spin-outs. These two pieces of research are based on a common data set which, while useful, needs to be more developed in order to provide a fuller, more accurate picture of the financing needs of these organisations. In particular, expert analysts from Deloitte particularly highlighted the absence of robust data on profitability.

Case study – Ripplez CIC

Ripplez CIC is an independent social enterprise in Derby which provides NHS services to young parents who are aged 17 or under in their first pregnancy. This Family Nurse Partnership programme was developed as a preventative, early intervention aiming to improve the lives of young parents and their children. The service provides intensive home visiting, delivered by specially trained nurses.

Ripplez became independent in January 2011 and has grown 400% since 2007, now working in Derby City, Derbyshire and Burton. In 2012, Ripplez was one of the Big Venture Challenge winners. >> See www.ripplez.co.uk

---

1 Scaling up your business: Expansion models for spin-outs by Dan Gregory (Transition Institute; 2012; www.transitioninstitute.org.uk)
2 NCVO Almanac, 2012; www.ncvo-vol.org.uk
3 For instance, there was no survey data for profitability per se and some responses were inconsistent with responses to earlier questions.
4 Competition run by UnLtd where the winning social ventures receive access to finance, business support and connections to help them scale their ventures. See www.unltd.org.uk
The Story

As part of this research, we have collected a range of qualitative evidence from partners, first-hand from the spin-outs themselves, from investors and intermediaries, from publications and other sources. In this section, we reflect on how spin-outs’ finance needs are perceived, the types and sources of finance available to them, their perceived ‘investment readiness’ and consider how social return plays a role in their ability to attract finance.

Why do spin-outs need finance?

As Social Finance⁵ points out “It is important to note that not every spin-out will require capital to grow”.⁶ Social Finance do, however, suggest a range of reasons why spin-outs may seek investment:

• working capital, to cover the costs of delivering the service prior to being paid;
• for any immediate capital requirements such as new IT systems or asset refurbishment;
• for services that are not covered by an initial contract but need to be sustained prior to winning contracts;
• new staff with skills that are particularly likely to be required, including business development and finance functions; and
• external support if the spin-outs lacks expertise in specialist areas such as marketing and legal advice.⁷

Discussions among the spin-outs themselves echo this analysis. We categorise the needs of these organisations in four areas – assets, working capital, payment by results and growth and innovation. In addition, we also consider performance bonds.

Case study – Sirona Care and Health

Sirona Care & Health Community Interest Company (CIC) delivers tens of millions of pounds worth of integrated health and social care services in Bath and North East Somerset. The enterprise was created in October 2011 as an independent non-profit distributing business delivering services on behalf of both the NHS and the local council.

Sirona delivers a range of community healthcare and adult social care services, including audiology, learning disabilities services, residential care and sexual health services, among others. Sirona pays no dividends and any surpluses will be reinvested into the development of health and social care services and staff. >> See www.sirona-cic.org.uk

Assets

A number of spin-outs report that they are interested in attracting finance in order to acquire assets. This interest in asset acquisition is shared across the wider voluntary, community and social enterprise sector, in contrast to the experience of the public and private sectors which have, over the last few decades, more commonly sought to dispose of assets not central to their core business, for example, through sale and lease-back arrangements, etc. This is inevitably linked to the idea that the sector is undercapitalised relative to others and that asset acquisition is one way to develop the sector’s asset base. Indeed, 90%⁸ of finance provided by specialist social investment intermediaries is provided in the form of secured (asset-backed) lending.

---

⁵ Social Finance are a leading social investment and finance intermediary, operating primarily in the public services space
⁶ A Technical Guide to Financing New Employee Mutuals (Social Finance; May 2012; www.socialfinance.org.uk)
⁷ Ibid.
⁸ GHK, forthcoming
There are two widely perceived problems here for spin-out social enterprises. First, that they are understood to be cash-rich and asset-light, emerging from their parent organisations with multi-million pound multi-year contracts but with a starting point of few, if any assets. Second, purchasing an asset with a lifetime and with associated finance that extends beyond the duration of their initial contracts, assumes a certain appetite for risk on behalf of both investor and investee. One emergent enterprise explains:

“It goes back to the contract and it’s more about term. If we wanted to buy a big asset, a community hospital, we need some certainty that there is a much longer term agreement. Yes, we’ve got three years but that’s not good enough. It won’t convince people who invest or put the funding behind us to make an investment on our behalf.”

Working capital
Working capital is also assumed by some to be a core finance need of the spin-out enterprises. Social Finance, for example, have suggested that large community health spin-outs have “required finance to cover start-up and working capital costs over their first few months of trading in the range of £0.5 million to £1.7 million for organisations employing 1,000–2,000 members of staff.” For smaller organisations, “working capital requirements may be much higher... equal to at least three months’ of fixed costs: £0.5–£0.7 million for 100 members of staff.”

However, many spin-outs report securing initial contracts with payment in advance. One spin-out describes how “We were expecting quarterly or monthly [payments] and then it dropped in to our account all at once. We were fortunate.” Not all spin-outs benefit from such generous terms, which often depend up on what was negotiated as part of the spinning out process, though many others do report securing similarly favourable arrangements.

Payment by Results
The present Coalition Government has put much emphasis on the potential of Payment by Results (PbR) models which seek to transfer risk away from the taxpayer. Finance which not only covers the period until which payment arrives but which is also willing to take on the risk that it may never arrive - if the services fail to deliver the expected results - is therefore another potential requirement for new spin-outs.

Payment by Results programmes may require several million pounds of up-front investment. Social Finance describe how “many spin-outs are finding that they need to compete with well capitalised private sector providers or enter into new payment by results contracts that require providers to fund their services up-front and receive payment only if outcomes are achieved.”

However, PbR has a higher profile in the areas of welfare-to-work and offender management than in the provision of health and social care services, at least to this point. Hence, spin-outs themselves tend to put less emphasis on the need to secure finance for these purposes than for other priorities, such as asset acquisition.

Growth and Innovation
Spin-outs, like other social enterprises, are often expected to be keen to grow in order to increase the impact they are having. What’s more, their perceived reliance on one major contract offers another reason to seek to win other contracts – to diversify and mitigate risk. The Transition Institute have described the potential expansion strategies for spin-outs as follows: by geography; across conventional public sector boundaries; into private markets and the social economy, recognising that “investment which supports expansion needs to be attracted on appropriate terms with incentives aligned and a balanced sharing of risk and rewards”. Social Enterprise UK, among others, have suggested that joint ventures and other partnerships may be crucial vehicles for enabling expansion.

---

9 Social Finance report as previously indicated
10 Social Finance report, as previously indicated
11 Transition Institute report, as previously indicated.
Evidence suggests that the spin-outs are indeed looking to grow and deliver a greater number of contracts across new geographies and new service areas. As one emergent social enterprise reports “Our five year contract is going by very quickly so we need to look at other ways we can do business.” But this requires resources. As another health spin-out describes it, “Serco you know, they can put four or five million quid in terms of developing the business... We just don’t have access to that sort of money.” Another colleague echoes this:

“I saw how they worked. There is absolutely no way my organisation can compete with them... They were prepared to invest to make sure they won the contract... We could actually do with professional support in bid writing. We need help getting bids developed... We can compete with Serco [on delivery] but we just don’t have the [bidding] resources.”

**Performance bonds**

There are a number of terms for instruments which public sector commissioners may expect to see in order to convince themselves that they are sufficiently protected against the risk that a service provider fails to deliver. These include performance bonds, deeds of guarantee and surety bonds – agreements whereby a third party guarantor “undertakes to fulfil the terms of the contract and/or a financial guarantee that ensures the Authority receives financial compensation if the contract is not fulfilled... A performance bond can provide some compensation if the contractor is proven to have defaulted on its obligations.” Such agreements may be provided by insurers or banks.

There is often a perception that emergent social enterprises delivering health and social care can have problems securing performance bonds required by the commissioning body - or in order to gain access to the Local Government Pension Scheme - since it was reported that the spin-out Central Surrey Health failed to do so when bidding for a new contract. Cabinet Office, for example, suggest that “it may be difficult for the new body... particularly if it is a start-up without a financial track record or assets to secure the bond against.”

However, whether commissioners should use such bonds is contested. The Health Minister, Lord Howe, wrote in 2012 that “Central Surrey’s inability to provide a Bond was not a factor in it being unsuccessful”. He suggests that while the commissioners in the Surrey case initially requested a £10 million performance bond, departmental officials had intervened and this requirement was subsequently dropped. Cabinet Office have issued guidance which suggests that such bonds are only used in “exceptional circumstances”.

Nevertheless, these agreements appear to remain an issue. As one spin-out reports “We are finding a lot of commissioners saying they want a bond for anything from a million quid to five million quid...Commercial banks don’t just say yes... That’s another thing we would want.” Another describes how “One of the biggest challenges facing public sector mutuals in competing for contracts is the ability to demonstrate financial robustness in a downturn scenario. This requires access to up to 10% of the contract sum which means either a Parent Co guarantee, significant reserves or access to an unsecured loan - all a challenge for a new organisation.”

---

Case study – Chime

Chime is a new social enterprise created on May 1st 2011, which provides NHS Audiology Services in Devon. Audiology services, including hearing aids are still provided free at the point of delivery. Services include the provision of hearing tests for adults and children, hearing aids services, balance, tinnitus and hearing therapy.

Chime believe that the freedom they have as an independent social enterprise has enabled them to become more efficient and to reinvest any profits in the service rather than to shareholders or other parts of the public sector, creating better incentives and helping them to deliver the quality service.

Under the Any Qualified Provider policy, the provision of adult hearing aid services is being opened up to a range of public, private and social sector providers. In this context, Chime are well placed to provide alternative models to private businesses such as Specsavers. Chime is a Community Interest Company. >>See www.chimehealth.co.uk

What types of finance do spin-outs need and where can they go?

Finance comes in a variety of forms and should be appropriate to its purpose. Potential types of investment for spin-out social enterprises include grants, secured debt, unsecured debt, equity, quasi-equity and other hybrid models. Like all social enterprises, it is important that spin-outs think carefully about the finance that suits their needs, the risks and opportunities. Spin-outs themselves are aware of this, with one stressing that it is “Important to make sure early on to have a good understanding of what your investment needs are likely to be”.

But most products can be ruled out. First, as most spin-outs will not only be unwilling but will be unable to issue equity to external investors, their ability to access equity-based risk capital is limited. Second, as 90% of specialist investment in social enterprises is provided in the form of secured lending - if these organisation do not have any assets against which they can secure investment, then this represents a significant hurdle to attracting finance. As one social enterprise says:

“This goes back to getting the social investors to understand the market more.... you won’t have any significant assets on which they can use as collateral... so you are up against a bit of a tough time to start with”.

The RSA go even further, suggesting that “In the absence of such assets, borrowing becomes almost impossible and the establishment of a sustainable business model that can meet the challenges of competition, unachievable.”

Invoice discounting and factoring

Invoice discounting and factoring are specific products which can support cash-flow. In invoice discounting, a business borrows against unpaid invoices. In factoring, a business actually sells (therefore this is not strictly a type of borrowing) its rights to income to a third party, called a ‘factor’, at a discount in order to see the cash more quickly. It may also outsource some of the credit control work.

Sources of finance

The main potential sources of finance for these businesses include commercial banks, specialist social investors, grant-makers, venture capitalists, angel investors and ‘retail investors’ e.g. investing directly through bonds or community shares. Until recently, health and social care social enterprise have been able to access financial support from

---

Sources of specialist unsecured risk finance (in the form of debt, equity or hybrids) which may be suitable for spin-out social enterprises do exist. These include:

- **Bridges Ventures** – their Social Entrepreneurs Fund aims to “address the funding gap often faced by fast growing social enterprises looking to scale... for investment in scalable social enterprises delivering high social impacts and operating sustainable business models.”

- **Baxi Partnership** – which “offers its own fund dedicated to promoting strong, employee-led enterprises... can also advise on how to leverage investment capital from a broader set of sources.”

- **Social Finance** – who can provide support with “negotiations with external investment partners...Capital raising for those looking to expand or purchase assets.” as well as a VCT fund in partnership with the FSE20 group.

- **Capital for Colleagues** - established to invest in businesses which have a “significant commitment to employee share ownership”.

- **NESTA** – Impact Investments “invest in social ventures with innovative products or services that are addressing some of the UK’s most pressing challenges... seeking innovations that have a positive impact on... the health and wellbeing of an ageing population”.

- **Big Issue Invest** – which helps “scale up social enterprises and charities throughout the UK by providing loans and investments, not grants, from £50,000 to £1 million”.

Collectively, this amounts to several tens of millions of pounds available for investment. However, evidence suggests that there has been a relatively low level of engagement so far between the sector and this range of investors. One large spin-out does report talking to Bridges but their potential finance needs (for a business with hundreds of millions of pounds of secured income over many years) dwarfs the relatively small Bridges fund. Bridges themselves have expressed interest in engaging more closely with the spin-outs on a number of occasions. This distance may be partly due to reluctance from the spin-outs to come forward, as one investor suggests, “I would like to believe that perhaps the reason we didn’t have a lot of requests from relatively recent public sector spin-outs is because in the early years they didn’t need any capital I think in many cases at the first year or two there wasn’t a real need.”

One spin-out has made progress in seeking finance from a perhaps unconventional source – an overseas supplier of clinical equipment. A board member at this enterprise reports that:

“if you went to the normal financial providers it’s not going to work. It’s just not going to work. They’re going to want a profit. We’re a not-for-profit organisation. It’s not going to work. We’re also an unstable organisation. We’re new, we’re young, we’ve got very limited reserves, high risk, volatile sector. We all know it’s just not going to work.”

---

16 Fund set up by the Department of Health to stimulate the part played by social enterprise in the health and social care sector by making investment available to new, start-up and existing social enterprises
17 Bridges Ventures is a specialist fund manager, using impact investment to create returns for investors and society www.bridgesventures.com/bridges-social-entrepreneurs-fund
18 Baxi Partnership are a specialist support organisation for employee-owned businesses http://www.baxipartnership.co.uk/what-we-do/funding/
19 www.socialfinance.org.uk/work/capital-raising/mutuals
20 FSE is a finance intermediary which provides tailored funding and support for Small and Medium Enterprises (SMEs)
21 Capital for Colleagues provides information and advice on employee share ownership (www.capitalforcolleagues.com)
22 NESTA is an independent charity focusing on financing and supporting innovation [http://www.nesta.org.uk/investment/impact_investments]
23 Big Issue Invest is a specialist social investment and finance intermediary (www.bigissueinvest.com)
24 Gathered as part of the research for the forthcoming publication, The role of mutuals in public service innovation, Lyon, F et al, Middlesex University
Instead, the spin-out reflected on their business and thought “who will benefit from our expansion?” and concluded that the answer was their supplier. “So it presents an opportunity and we had some really fascinating dialogue with companies for whom this is new ground too. You know, they’re not used to this, so they’re struggling a bit with it as well. But it’s been really exciting, actually, talking to them.”

Are spin-outs an exciting investment proposition?

There are a number of common perceptions about the recent network of spin-out social enterprises in terms of their suitability for investment per se, and vis-a-vis ‘conventional’ social enterprises.

The spin-outs are often seen as being attractive to investors in terms of having relatively long-term contracts, often strong cash-flow, being bigger than the average social enterprise, sometimes structured to take equity investment, dominating local markets and with relatively dynamic leaders compared to conventional public sector organisations.

As the City of London suggest “Health and social care spin-outs have had... advantages... the health sector budgets, whilst they have been re-configured, have not gone through the same degree of reduction as other sectors are facing.” Simon Evill from ClearlySo is also quite bullish, saying “When there are examples of health and care spin-outs being invested in I don’t think the rest of the sector will find it difficult to... I would say that health spin-outs by their nature will be far more business-like than the bulk of social enterprises.” Social Finance report that spin-outs have:

“good underlying propositions and as early entrants into new public service markets should be well placed to win other contracts... are often managed by some of the most entrepreneurial leaders in the public sector... may hold initial multi-year contracts, have good relationships with commissioners and have the scope to make rapid productivity gains through improving staff motivation.”

On the other hand, these businesses are sometimes perceived negatively to have a limited track record as new entities, just one or two contracts, a lack of assets, to be operating in a highly unpredictable market environment with highly aggressive, professional and well capitalised competitors. One investor reported that “we are exercising some caution about NHS public sector mutuals at this stage until the commissioning environment becomes more clear”. Furthermore, the RSA suggest that “some public sector workers (for example, health clinicians) may not have the management and business skills required to set up and run a social enterprise within a competitive marketplace.” Others are more impressed by the capacity of the spin-out group, while suggesting that any perception of risk is related to external factors only. Ed Siegel from Big Issue Invest sums up this perception in the investor community “If you have only one customer, only one contract that is pretty risky... we would hope than from when you span out you had some success in diversifying away from that single contract.”

As the City of London describe “Public sector spin-out investment opportunities are of interest but are viewed as risky... clarity over contracting arrangements for spin-outs... is vital to reassure investors in the business proposition.” Social Finance suggest that the challenges for spin-outs include “the transfer of liabilities, limited commercial experience, few assets and often a strong reliance on an initial contract... gaps in business capabilities, market uncertainties and legal forms which may put off investors.” They also report how spin-outs “may not find it easy to attract finance, due to a lack of assets and track record.”

---

26 Clearly So is an investment intermediary which connects social business & enterprises with potential investors and corporations
27 www.thersa.org/__data/assets/pdf_file/0004/1523497/RSA-Spinning-Out-or-Standing-Still-May-2013.pdf
28 Big Issue Invest is a specialist provider of finance to social enterprises or trading arms of charities
30 www.socialfinance.org.uk/sites/default/files/sf_emp_mutuals.pdf
The RSA are also sceptical, reporting that access to capital will be a significant challenge for new spin-outs, describing how “A great deal depends on the solid and durable nature of their initial contract and the existence of any capital assets against which they might be able to borrow from the open market of suitable social finance intermediaries.”

Spin-outs themselves describe a range of barriers to accessing finance, also citing in-house expertise and associated costs as a particular issue. One social enterprise, for example, describes how “The cost of the expertise to support us through the process as well as in particular the legal costs were (are) prohibitive” while another reports that “Where you have to deliver on contract numbers, it’s very difficult to free existing people for new roles”. This message comes through quite strongly from a number of spin-outs. Others regret that is “difficult to get a business case together when trying to run existing services on a shoestring” and that “A sound business case will attract finance, the real barrier to expansion is lack of in-house expertise.”

Perception of risk among the investor community as opposed to ‘true risk’ has also been underlined by several spin-outs, remarking that “Lenders don’t understand new organisations without a track record.” Or that “It’s trying to get them (social investors) to understand what is the real risk in the project. How do we convince them the risk isn’t as big as they previously thought?” Several acknowledge that there are issues associated with a “weak balance sheet, short contract lengths, risk around contract income” but maintain that the market advantage held by spin-outs make them a much more investable proposition than many other social enterprises.

**Case study – Social adVentures**

Social adVentures is a social enterprise jointly owned by service users, employees and local people in Salford. The business works from three primary locations - The Angel Centre, The Creative Media Centre and Garden Needs, all providing a range of activities aimed to improve wellbeing, health and happiness.

While some of the services have a track record of over 10 years, the enterprise has developed into an independent mutual. A public health contract with Salford NHS, rental income and other revenue streams have helped grow the business since its independence. Any surpluses are re-invested to improve services and make a difference to the people of Salford. Social adVentures won the RBS SE100 Growth Champion Award in 2012, and is a Deloitte Social Innovation Pioneer. >>See www.socialadventures.org.uk

**How does social return fit in?**

It is also worth noting some potential confusion in the market around the idea of ‘social return’. Much of the interest in social investment from the social enterprise community is linked to the understanding that a number of investors exist who are “motivated by achieving social as well as financial outcomes... will also want to see evidence that they are supporting an organisation that achieves social impact.” Ed Siegel from Big Issue Invest reinforces this message:

> “all the investments that we look at, we need the investees to be able to articulate fairly well the social impact that they think they are having because that’s important to us... We expect our investment applicants to have thought through the social impact that they are having, evidence to that impact by monitoring and reporting on a set of social KPIs (key performance indicators). Hopefully, just as they would set annual financial plans for financial performance and growth, similar types of exercise taking place around the social performance of the business.”

Yet the evidence suggest that even where social return is taken into account it does not necessarily influence the investment terms in a way that makes them any more generous than finance provided by purely financially motivated commercial investors. Yet the

---

32 Social Finance report, as previously indicated.
spin-outs, like many other social enterprises, interpret the rhetoric around social return and social investment to suggest that there could be a good generous offer on the table. As one suggests:

“It’s about trying to convince those social investors that it’s not just about financial return for them and this is something I certainly struggled with. They shouldn’t be looking for double digit return, they should be looking at very small financial returns and… social impact.”

But in reality, social factors do not appear to be influential enough to make investment terms sufficiently attractive to the spin-outs. One even suggests it works the other way, commenting that “investors were looking for a financial return that was linked to the social return but it went up when the social return did rather than going down when the social return went up. I wonder whether you thought through your blend of social versus financial.”

While the social impact should matter to investors - as one puts it informally, “sometimes the social does convince people to have a go” - it does not appear to play a role in softening the financial terms, as many social enterprises imagine. As Ed Siegel admits, in line with other investors’ behaviour:

“There is not typically a firm link between social returns and our expectations in terms of pricing ... It would be nice if we could offer structures in which there is an inverse relationship between social performance and financial return, but most of our own funding has a financial cost which doesn’t allow for such a trade-off. That said, we have on a few occasions been able to structure offers in such a way that truly superior ‘off the charts’ social performance during a particular period of the investment is rewarded by a pricing reduction in the same period.”
The Evidence

Data collected from 27 health and social care spin-outs has enabled us to undertake a quantitative analysis of the current state and trends in the financial challenges facing the sector. These organisations vary by size, geographic coverage, services and other factors.

Governance and ownership

Our health and social care spin-outs exhibit diverse ownership characteristics.

The ability to access external finance varied in terms of its significance in shaping these organisations’ choice of legal structure - as many respondents suggested that it was unimportant as those who deemed it to be a very important factor. The largest group were those who said it was moderately significant.

Perhaps counter-intuitively, those who said it was not at all important opted for a CIC limited by share model, which suggests that this form was preferred for other reasons, such as its potential for awarding shares to staff or users. This is backed up by the evidence that those nine organisations where employees had direct control in the governance arrangements were CICs limited by share.

Income and profitability

The average (mean) turnover in the 2012-2013 fiscal year of the surveyed group was £17,936,000 (the median was £2,900,000). CICs limited by guarantee tended to be larger than the CICs limited by share with both higher mean and median turnover.

In contrast to the perception that spin-outs all have one major contract, the mean number of contracts at launch was six and the median two. This has grown since launch, demonstrating the spin-out enterprises’ abilities to diversify their income sources, with a more recent average of nine contracts (the median has doubled to four). The average length of contract is over 40 months.
While no data for profitability was available per se, spin-outs do appear to be in decent health in terms of profitability, as the following table suggests.

What best describes the surplus/margin on your main contract you achieved?

- More than 10%
- 5 - 10%
- No margin
- Less than 5%
- Other/unknown

Almost all the organisations with just one contract made at least a modest surplus on this contract. While for organisations which have more than one contract, the overall profitability was similar but appears to be slightly more mixed.

What were the payment terms on your main contract?

- Advance monthly
- Other/unknown
- Advance quarterly
- Arrears monthly
Confirming anecdotal reports, respondents reported relatively generous payment terms, although this was not universal. Cash positions were therefore relatively strong for a number of spin-outs, although still fragile for some.

*During the initial contract phase, for how many weeks could you sustain operations from your cash reserves?*

- **Up to 2 weeks**
- **3 - 4 weeks**
- **5 - 8 weeks**
- **9 - 12 weeks**
- **12+ weeks**
- **Other/ unknown**

The spin-outs also seem to be performing very well in picking up new work, winning two out of every five contracts for which they have competed, which compares very favourably to reported success rates of large private competitors across public service markets. The nature of these new contracts varies, including picking up work from current commissioners, in new areas and new sectors (although only once in a new sector and new area at the same time).

**Assets**

In contrast to the reported story of the spin-out sector, nine of these social enterprises had some assets on their balance sheet at launch, although 17 did not. The assets were, however, relatively small, averaging £124,000 (median was £50,000) and ranging from £10,000 to £450,000. This represents around just 1% of turnover and compares to Social Finance’s earlier analysis of a number of the larger spin-outs, which concluded that some large community health spin-outs may have £80m turnover but only £800k of tangible assets. Compared to the social sector as a whole this provides us with a sector which is relatively light on capital - NCVO figures suggest that voluntary sector income is almost £40 billion per year with total assets over £100 billion. This suggests an urgent need for capitalisation of the spin-out sector even if the spin-outs themselves are not yet feeling such urgency or finding solutions. Of those organisations which had sought external finance, none of them had any significant assets on their balance sheet.

**Case study – City Health Care Partnership (CHCP)**

City Health Care Partnership is an independent co-owned business providing integrated health and social care services in Hull and East Riding. The business employs over a thousand people and delivers contracts worth tens of millions of pounds.

Services include early interventions and promotion of healthy lifestyles in community settings, including district nursing, health visitors, sexual health and dentistry as well as a pharmacy business. CHCP is already developing plans to provide support and funding to other local social enterprises and charities. The organisation is a Community Interest Company. **>> See www.chcp.hull.nhs.uk**

---

32 Social Finance report, as previously indicated.
Early stage finance

Only four organisations surveyed had sought external finance at launch phase, ranging from £20,000 to £2.7m with an average of £958,000 (median £556,000). Unsurprisingly perhaps, there appears to be a link between turnover and finance required.

The data on sources of finance was unclear in places with some seemingly contradictory responses. This may suggest ongoing confusion around what is meant by social finance - or investment more widely - and the need for greater clarity around the sources of finance. However, the survey suggests that one spin-out has been successful in securing finance from a commercial source and also from a social investor while others have seemingly secured grants from government and other grant-makers.

Seeking finance

In the initial contract phase, just five organisations have been seeking finance at an average level of £817,000 and median of £450,000. This is much higher than the median level of finance sought in the social enterprise sector more widely (at £58,000\textsuperscript{34}), reflecting the relatively large turnover of many of these spin-outs. Sources considered included commercial and social investors, government funds and former parent organisation. Finance was sought predominantly for asset acquisition and growth.

What were the main activities that you needed the external finance for?

- asset purchase
- investment to win new contracts
- frontline service innovation
- professional services
- back office systems innovation
- acquisition (in ‘other’)

Those who chose not to pursue external finance, suggested it was either not necessary (as they could use reserves) or that interest rates were “very high and so not attractive”. One organisation is seeking a loan from a supplier, as outlined above.

\textsuperscript{34} Fightback Britain (Social Enterprise UK, 2011; http://www.socialenterprise.org.uk/uploads/editor/files/Publications/Fightback_Britain.pdf)
Prospects
Spin-outs are generally optimistic about their prospects, with 22 of the respondents expecting higher turnover in the near future and only one lower. However, this is only very small growth, with an expected increase in turnover of 0.6% across those surveyed 2012-13 to 2013-2014. None are expecting to lose contracts, 20 expect to expand into new geographical areas, and 18 are expecting to generate greater margins and have a healthier balance sheet over the next few years.

Half the respondents are expecting to attract more external finance and almost half staying as they are. But access to finance is seen as an obstacle to future growth by only three respondents, compared to five who are worried about the economy, twelve about commissioning, nine about competition and four about taxation. This compares to access to finance as the biggest single barrier to growth for 39% of the wider social enterprise sector, although prohibitive commissioning / procurement and the economy do also feature as significant problems.

Case study – Spectrum Community Health CIC
Spectrum Community Health CIC, based in Wakefield, provides a range of advice, care and treatment services on behalf of the NHS. Spectrum aims to support the most vulnerable groups in the most difficult environments, including people with complex health and social care needs.

Services include primary healthcare for people in prisons, specialist drug and alcohol services and sexual health services. Spectrum believe that their flexibility as a social enterprise helps the organisation to be responsive to the needs of the local community.

>> See www.spectrumhealth.org.uk

Social return
While a weak response to a survey does not necessarily mean this applies to the organisation as a whole, the respondents were not very strong in articulating their social impact. Some of the organisations surveyed are known to have produced relatively robust social impact reports but this did not come through in the survey for the spin-outs as a whole.
Conclusions

The first aim of this report is to increase understanding of the finance needs of the health and social care spin-out social enterprises. The qualitative and quantitative evidence available suggest that these organisations:

**In relation to investors**
- have not yet engaged to a large extent with external investors or secured significant finance;
- are currently seen as risky propositions by investors. Yet they could be exciting investment propositions, successful in growing and picking up new work, profitable and often with multiple long-term contracts;
- are sometimes unsure or not clear where to turn for investment; and
- may benefit from looking outside the usual suspects for solutions to their finance needs.

**In relation to finance sought**
- are not struggling with cash-flow or a need for working capital (although this may change in future) - Payment by Results is yet to play a significant role in the market in which they operate;
- are seeking to build stronger balance sheets, including through acquiring assets. This may be complicated by contracts which, although multi-year, have limited time horizons;
- are increasingly seeking finance for growth and innovation; and
- when they are seeking finance, may require larger sums than other social enterprises, up to half a million pounds and more.

**More widely**
- often have governance and ownership structures which restrict the potential for conventional equity investment and a lack of assets which limits the scope for secured lending. They may therefore need access to hybrid equity-like capital or to experiment with joint ventures which allow conventional equity investment while retaining their social purpose;
- sometimes face challenges with requirements for performance bonds;
- when they have engaged with specialist social investors with capital to invest, investment terms are less generous than expected; and
- share many challenges with other social enterprises, although with some that are specific to this group of spin-outs
A new model that builds on mutual values?

If external investors continue to perceive that these social enterprises are not sufficiently attractive propositions, then the network could itself look to explore its own finance solutions. Not least as some of the larger organisations have cash reserves which are more than sufficient to cover the access to finance needs of their smaller peers and indeed, some spin-outs are already actively looking to invest in other social enterprises.

This idea takes inspiration from mutual values and peer-to-peer models such as Zopa, which has now lent more than £200m and Funding Circle, which has lent over £50m as well as developing partnerships with, for example, Lancashire Council.

If even a tiny percentage of a spin-out enterprise’s chances of future success is connected to the success of the wider network, then it makes sense for an individual spin-out to invest an appropriate proportion of any of its available resources in the wider network. Pooling some resources through a special purpose vehicle (an Industrial and Provident Society or Limited Liability Partnership) would have the benefit of both limiting financial risk and sharing it in case of failure. In the case of success, it could ensure that any returns would be reinvested in social enterprises, rather than accruing to external (possibly just-for-profit) investors.

Further to this, the City of London have suggested that “Further use of pooled products could support public sector spin-outs, help to diversify the risk across the portfolio, raise the minimum investment size and provide some economies of scale.” Others have similarly suggested that such a consortium would also make it easier for other senior investors to invest.

For such a model to attract finance from other sources, and to take higher-risk positions that meet investee needs, it would require a significant degree of what we might call Tier 1 Capital – a cushion of equity or equity-like capital which could absorb potential losses. This could be achieved through the spin-outs investing in a co-owned finance mutual, and could be supported by others taking relatively risky positions, underwriting or providing equity or equity-like patient capital as described by the Cabinet Office in their recent report on co-mingling. The Department of Health could potentially play a role here (backed by the value of SEIF returns), as could Big Society Capital, the Mutuals Support Programme, or foundations such as the Wellcome Trust; a community share issue or regulated community finance platform (as per Abundance Generation’s model) could also be considered.

If such a model was to be viable, further work would be required in terms of:

- determining the necessary size of the fund, the management and governance requirements, regulatory landscape and more. It may be that such a model could be tested in ‘shadow form’; with a committee considering deals the only architecture required in the short-term, rather than full new institutional arrangements.
- demonstrating a convincing pipeline of deals, not least in the light of the relatively subdued appetite for finance evidenced in this research.
- ensuring that this model dovetailed with models under development by the likes of Local Partnerships, The Social Investment Business and Baxi Partnership, who have been exploring related ideas for some time.

---

35 Alongside the example of the investment by a clinical equipment manufacturer, this serves to demonstrate how investors often have wider motivations than the explicit financial terms of a deal.

36 City of London report, as previously indicated.


38 Big Society Capital is a wholesale social investment intermediary independently set up to develop the UK’s social investment market by giving organisations tackling social issues access to a new source of finance via social investment finance intermediaries (SIFIs).

39 Local Partnerships is a company which is jointly owned by HM Treasury and the Local Government Association, providing advice on infrastructure, legal and contractual matters to the public sector.

40 The Social Investment Business is a social investment intermediary which, alongside the Adventure Capital Fund, make up the SIB Group.
Recommendations

The second aim of this report is to prompt the development of appropriate investment solutions to address the needs of these spin-out social enterprises. Our recommendations fall into a number of distinct areas:

**Assets**

**Recommendation 1.** The spin-out social enterprise network should explore how challenges around contract length and asset life might be overcome by partnering with organisations such as CAN\(^\text{41}\), the Ethical Property Company\(^\text{42}\), Ashley House and Primary Health Properties.\(^\text{43}\)

**Recommendation 2.** To overcome the challenge of building balance sheets from a standing start, as SocialadVentures suggest, the “other route would be partnering with an organisation that does have balance sheet strength”. Spin-outs should explore, individually, the potential for partnerships, joint ventures and even mergers with the likes of Housing Associations and Leisure Trusts, health-focused trusts (e.g. Wellcome Trust or the Nuffield Trust) and larger existing charities, social enterprises, mutuals and employee-owned businesses – such as Scope\(^\text{44}\), Macmillan Cancer Support\(^\text{45}\), the Co-operative Pharmacy\(^\text{46}\), etc.

**Recommendation 3.** The spin-out network should collectively approach socially-oriented banks (e.g. the Co-operative, Triodos Bank, Unity Trust Bank and Charity Bank) offering to negotiate an agreement for the provision of banking services alongside a serious commitment for one of these banks to support the network’s longer-term finance requirements.

**Performance bonds**

**Recommendation 4.** The health and social care spin-out social enterprises, the Department for Health’s VCSE sounding board secretariat, Monitor and the Cabinet Office SME panel team should work together to clarify on what occasions, if any, performance bonds are appropriate and proportionate and develop solutions to ensure spin-out social enterprises are operating on a level playing field.

**Equity-like risk capital**

**Recommendation 5.** Big Society Capital and partners in the social investment market should publish case studies of equity-like risk capital which are appropriate for social enterprise.

**Recommendation 6.** The Cabinet Office Mutuals team should publish examples of where joint venture models have enabled social ventures to attract external equity finance whilst safeguarding the social purpose of the public service mutual.

**Recommendation 7.** The social enterprise spin-outs should explore, individually, where potential other sources of investment may lie, including less immediately obvious solutions including angel investors, suppliers, peers, private sector partners, staff and local investors through a community shares model\(^\text{47}\), and further afield.

---

\(^\text{41}\) CAN is a social enterprise which aims to develop other charities and social ventures through offering business support, capital and office space (www.can-online.org.uk)

\(^\text{42}\) EPC is an organisation that provides office space for charities, voluntary groups and social change organisations (www.ethicalproperty.co.uk/).

\(^\text{43}\) Businesses which manage health care properties.

\(^\text{44}\) Scope is a charity based in the UK working with disabled people and their families (www.scope.org.uk)

\(^\text{45}\) Macmillan is a charity based in the UK supporting cancer patients and their families (www.macmillan.org.uk)

\(^\text{46}\) Co-op Pharmacy is the third largest pharmacy in the UK, providing a range of healthcare services (www.co-operativepharmacy.co.uk)

\(^\text{47}\) Together with the advent of AQP, personalisation and individual budgets this introduces the exciting model of a user-owned consumer co-operative spending their budgets with their own business. NB: Only around 3% of community-owned shops have ever failed.
**Recommendation 8.** The social enterprise spin-outs should explore, collectively, with input from a number of nominated Financial Directors, the scope for pooled investments, in line with mutual principles and innovations in peer-to-peer finance. This would include consideration of:

- the potential role of a special purpose Industrial and Provident Society or Limited Liability Partnership structure;
- the scope to attract finance from the Department of Health (backed by the value of SEIF returns, for example), Big Society Capital, foundations and ‘retail’ investors;
- how to mitigate risk through directing a proportion of the capital towards lower risk investments;
- the size of the fund, the management and governance requirements, regulatory landscape and more, as well as testing the model in ‘shadow form’;
- the need to demonstrate a convincing pipeline of deals and take into account work under development as indicated above.

**Communications**

**Recommendation 9.** Social investors and advocates of social investment should be clearer about the terms of available investment - including how social return plays a part - so as not to unduly raise expectations among potential investees, attract inappropriate demand and increase transaction costs and frustrations for investors and social sector organisations alike.

**Recommendation 10.** The spin-out network should commission a ‘myth-busting piece’ to help communicate their particular role as diverse, confident, health and social care social enterprises with asset locks and mission locks, various degrees of mutual and employee ownership, growing businesses, delivering value, winning multiple contracts and engaging staff.

**Investment readiness**

**Recommendation 11.** Investors, particularly specialist and social investors should consider health and social care spin-outs as a potentially exciting investment proposition. They should reconsider their perception of risk and develop a strategy for engaging more closely with these businesses in a spirit of mutualism and cooperation, together developing products that are fit for purpose.

**Recommendation 12.** Spin-out social enterprises should consider approaching either the Cabinet Office’s Investment and Contract Readiness Fund (for larger spin-outs), or the Big Lottery’s Big Potential programme (for smaller businesses).

**Recommendation 13.** Intermediaries like Social Enterprise UK and others should support the spin-outs to better help navigate the market for investment and broker introductions where appropriate.

---

“Together with the advent of AQP, personalisation and individual budgets this introduces the exciting model of a user-owned consumer co-operative spending their budgets with their own business. NB: Only around 3% of community-owned shops have ever failed.”
Social return

Recommendation 14. Social investors and potential social enterprise investees should better articulate their approaches to social impact measurement and reporting.

Further research

Recommendation 15. The spin-out network should take ownership of their own data collection, seeking support from the Mutualls Support Programme, if necessary. Rather than surveys being undertaken by private partners, this would engender higher levels of engagement, enable the development of more robust and comprehensive data and could represent better value for money.

We hope this research shines a light on the finance needs of an exciting group of new enterprises and helps a range of partners develop solutions in their mutual interest. We look forward to seeing these spin-outs deliver even greater care and value across the country over the coming years.
For more information on some of the social enterprises in the network, please visit the following websites:

**Accelerate CIC**
www.acceleratecic.com

**Care Plus**
www.careplusgroup.org

**City Health Care Partnership CIC**
www.chcphull.nhs.uk

**Locala Community Partnerships**
www.locala.org.uk

**Social adVentures**
www.socialadventures.org.uk

**Spiral Health CIC**
www.spiralhealthcic.co.uk

**Community Dental Services**
www.communitydentalservices.co.uk

**Bevan Healthcare**
www.bevanhealthcare.nhs.uk

**Central Essex Community Services**
www.cecs.org.uk

**Enable2**
www.enable2.com

**NAViGO**
www.navigocare.co.uk

**Plymouth Community Healthcare**
www.plymouthcommunityhealthcare.co.uk

**Spectrum Community Health CIC**
www.spectrumhealth.org.uk

---

**Social Enterprise UK**
Social Enterprise UK is the national membership body for social enterprise. Our members come from all sectors. What unites them is their belief in the power of social enterprise – business where society profits.

www.socialenterprise.org.uk