Social Economy Finance in Northern Ireland

Working Paper 1: Review of the Finance Literature

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1. Introduction

This paper sets out a review of the literature on the demand and supply of financial products for the social economy. The Working Papers for the Review of the Social Economy (2001) in Northern Ireland contained background information and reports of research into the distinctive financial environment in the social economy and this paper adds a more specific literature to these baseline reports.

The paper attempts to develop themes relevant to the development of policy and programmes in Northern Ireland rather than describing the extent of the literature available in the texts. The report looks at:

- Financial and fiscal instruments;
- Strategic analysis and policy on supply and demand;
- Lubricating the market;
- Measurement and social auditing; and
- The implications for Northern Ireland.

This Working Paper records work in progress and will be developed over the course of the assignment. We are especially interested in any material that the Steering Group might want to see included in the analysis brought into the final version of the literature review.

2. Financial and fiscal instruments

Market failure: asymmetry in demand and supply

One of the current themes in the literature review is the asymmetry in demand and supply. In an extensive review of patient capital in Scotland CEIS (2002) showed that there was a "strong undercurrent of investor interest" (p. 9) based on the desire of the public sector to shift from grants to more commercial arrangements and the more straightforward profit motive of the private sector. They make the interesting point that traditionally the private sector has invested in the social enterprises for philanthropic or promotional reasons but that they are being increasingly attracted by returns available in growth areas of the sector. Picking up on this pattern, the Bank of England report on the Financing of Social Enterprises (BOE, 2003) showed that this emerging investment was in commercial businesses concerned ethical issues (recycling or ethical trading) rather than in social economy businesses per se.

The CEIS review argued that there was no technical bar to joining supply and demand but identified a number of dimensions to market failure that are especially relevant to Northern Ireland:

- Information and knowledge is the primary obstacle to efficient market operation both in terms of those seeking resources and among those attempting to make investments.

- A sustainable deal flow has two dimensions in that the size of investment and availability of a commercial return will dissuade private sectors especially on a comparative basis with other sectors.

- Exit strategies are not clear for investors in social enterprises. It might be clear how they put money into the organisation but it is less clear how they get it out easily and efficiently.

- Transaction costs on equity deals tend to be high given the technical competencies and systems required to maintain the investment. It is worth noting that Social Investment Scotland carries a significant development budget to prime the market, which has important implications for stimulating demand in Northern Ireland.

- Culture and skills gaps especially in moving the community and voluntary sector from a grant to loan based funding arrangement is a significant short tem obstacle. CEIS highlighted the contradictory value base of the public sector and its concern for accountability and the private sector with its acceptance of risk and flexibility in investment decisions.

The CEIS report emphasised the need for an integrated policy and programme agenda that again has particular relevance for Northern Ireland. There is a need to develop an institutional infrastructure that lies in harnessing the skills of the private investment community in mainstreaming social economy investment including:

- The need to educate the market place in both demand and supply sides.

- Action is needed to create and retain surpluses in social economy organisations.

- The need to unblock constraints to developing an equity market which includes:

    - the absence of exit mechanisms for investors;

    - the limited size of the market and its effects on transaction costs;

    - the relatively high cost of development support;

    - the lack of appropriate investment skills in the social economy;

    - the need to foster demand that is latent, via education, marketing and demonstration projects (CEIS, 2002, p. 4).

Box 1 Linking the leading social enterprises on supply issues

The CEIS Review recommended a focused trawl to bring an initial 6-8 social economy organisations with the potential to grow their value through a mix of financial and social returns. They would be invited to work up equity or near-equity proposals with support from specialist agencies and Local Enterprise Companies. In order to identify this batch, CEIS suggested trawling of around 50-75 organisations and envisaged a balance between proposals aimed at attracting private investors focusing on size and stability and the public sector looking at newer enterprises and start ups.

Source: CEIS 2002, p. 15

In their report on *Revaluing the Social Economy in Scotland*, McGregor, Glass and Clark (2003) pointed out that 54% of all organisations surveyed identified difficulty in obtaining appropriate or sufficient funding as the main obstacles to sustaining or developing organisations. When assessing the needs of the organisation, 17% thought that making the organisation more business like was the priority whilst 10% thought strengthening the skills of managers and helping the organisation to become more financially sustainable was the key to long term growth. But the research showed that:

> the lending as opposed to granting agenda will be difficult to deliver, on the assumption we are talking about loans that must repaid notwithstanding the patience of the tender in terms of when this happens. However, one of the key constraints is revenue out of which to pay off debt, and the evidence of the survey is that revenues from

> charges has grown only modestly with even the largest social economy organisations still looking to grant funding in the first instance (McGregor et al., 2003, p. 34)

McGregor et al. also point to the contradiction in funding regimes whereby organisations that make surpluses are penalised by a progressive withdrawal of mainstream grant income. They are simultaneously being told to "be entrepreneurial but don't make surpluses" (p. 35). However, the report also showed that the bigger organisations attract more mainstream funding and that the larger they become the less likely they are to locate in or employ people from areas of high disadvantage. Dayson also made the point that:

> there has been a systematic failure with a 'grant culture' that has led to over-dependence and there was no incentives for private sector investment. Additionally a risk adverse culture has limiting business start-ups and entrepreneurship (Dyson, 2003, p. 9).

Supply and soft loans

Metcalf et al (2000) referred to the current supply of community finance as a "jumble" while Collin et al (2001) argued that even soft loans raise problems about their sustainability, community involvement and accountability. Here, Coparisow argues that micro-finance needs to be targeted on ethnic minorities, and women specifically to improve self-confidence, business survival rates and access to finance. Dayson usefully identified the reasons for the patchy development of Community Finance Initiatives (CFIs) in a UK context.

- Problematic definition of a charity;
- Failure to provide the right mix of grant and loan funding;
- Cultural inability to understanding that 'not for profit' is not charity or 'for loss';
- It is difficult for banks to support CFIs undertaking the same activity as themselves in areas they rejected and by using different methodologies;
- There is a lack of integrated welfare to work incentives;
- There is a lack of appropriate legislation and regulation;
- Credit Unions also have difficulties with bespoke lending, while the requirement to save before borrowing can exclude or delay clients;
- Soft loan schemes are too focused on the most deprived and often provided no opportunity for second loans (Dayson, 2003, p. 13).

In a separate report that helps to address these structural and cultural obstacles, Westall et al. (2000) identified the key characteristics of European wide CDFI activity and these are shown in the box below.

Box 2 Good practice in CDFI lending in Europe

- Lending to groups or individuals often based on peer lending where collateral is based on mutuality and social ties;
- Providing pure credit with business support;
- Financing of start ups or existing businesses (in which Westall et al. locate ASPIRE in Northern Ireland;
- Funding is targeted at specific groups such as women or ethnic minorities they may lend their money or act as a conduit for the lenders;
- Unlike Credit Unions, most CDFIs only offers loans due to local banking regulations;
- They provide ‘free loans’ or charge a commercial rate which imposes financial discipline on the borrower and helps the CFI become sustainable.

Soft loans were, in particular, regarded as a method to help shift organisations from grant to lending. Collin et al (2001) were highly critical of soft loans because a high proportion are unlent, default rates are also comparatively high and because of their poor disclosure practices. Coparisow argues that most Community Finance Initiatives have started small which has made them reliant on public subsidy for longer and at a higher cost. For Dayson (2003) the agenda for development consists of a number of interconnected stages:

- A cultural shift in both the operation of schemes including realistic interest rates and debt collection;

- Improvements in structures and the quality of governance, management and management information systems is needed to transfer soft funds into sustainable CFDIs.

- There is a crucial need to achieve cost minimisation by streamlining services through a technologically driven back office service with revenue maximisation (ie. issuing many loans) which overcomes the danger of limited growth enhancement in lost minimisation approaches.

Box 3 Aston Reinvestment Trust (www.reinvest.co.uk)

ART is one of the best known CDFIs and it operates in Birmingham as a Mutual Society providing loans to the voluntary organisations and SMEs which have viable projects that cannot obtain funding from mainstream banks. Their overall aim is to create local jobs for local people. ART's main features, as an Industrial and Provident Society, are: one member, one vote; maximum shareholding of £20,000 (individual or corporate), withdrawal of shares with 3 months notice; no prospectus or opening and closing dates required to issue shares; regulations of IPS similar to that of Credit Unions; ART raises money from private companies, personal investors, housing associations, charitable foundations and the public sector. To date they have raised some £2.4m including £417,000 in share capital from 172 members, £460,000 as subsidised long term social investment loans and £170,000 from public sector area regeneration initiatives. Loans range from £20,000 to £40,000 and repayments can be made from six months to 10 years, secured or unsecured, with capital repayment holidays if required. ART highlight the importance of scale economies in terms of geographical coverage, referral flow and loan portfolio. Ideally they would like to have a portfolio of £3m out on loan instead of £1.1m as at present.

The investor approach

David Carrington published a report titled, *The Investor Approach – A Way forward for the Community Foundation* in 2002 in which he outlined the need for philanthropic funders to concentrate less on their grants and what activities they produce and more on the *outcomes* yielded as a result of the investment. This approach has been picked up by the Department for Social Development led, Task Force into the future funding of the community and voluntary sector in Northern Ireland, especially in the context of the run-out of the Structural Funds after 2006 and continuing pressures on public spending. In particular it is viewed as a way of helping to ensure the financial sustainability of programmes, projects and organisations that can demonstrate discernable outcomes form any given financial investment by a funder.

Venture funding

The logical extension of the social investment model brings us to the whole area of venture style funding in the community and voluntary sector. Carrington (2003) carried out an important review of the origins, obstacles and development agenda for venture philanthropy in the UK context. Venture Philanthropy is:

> The use by grant makers and investors of certain principles traditionally associated with venture capitalists to either build the capacity of a non-profit organisation or to invest in a social purpose business venture. Key elements include long term relationships (three to six years), development of business plans, provision of cash and expertise and an exit strategy. Donors and/or investors make long term funding commitments, closely monitor performance objectives through pre-defined measurement tools and problem solve jointly with the leadership team on a regular basis (Carrington, 2003, pp.2-3).

Carrington identified the origins of Venture Philanthropy among academics, dot.com millionaires, advocates and what he terms frustrated Trust and Foundations. Lettes, et al (1997) from the Harvard Business School produced a review on *Virtuous Capital: What Foundations Can Learn form Venture Capitalists*, which set out six ingredients for success:

- Fund the general operation of non-profit organisations, not specific programmes;
- Fund long-term;
- Help organisations achieve financial sustainability as an exit strategy;
- Hold the organisations accountable for the results and reward them for succeeding;
- Take risks;
- Actively participate in helping organisations to succeed.

In a UK context, Carrington developed these rules and set out the obstacles to funders, in the philanthropic as well as Government sectors in their giving and investment strategies. He argues that the key mistakes in grant giving currently are:

- Grant makers are concerned with short term support tied to tangible and measurable outputs;
- Their application forms and programmes have tended to concentrate on the activities that their funds will be used for – not outcomes;
- Grant makers rarely provide sufficient resources to ensure that monitoring and evaluation builds learning and reflective practice;
- Many grant makers fail to pay for the full price of the work which will include general running costs, forward planning, central overheads and building up of working capital;
- Very little use of made of monitoring reports by the funder, especially in feeding back support to the recipient.

The central challenge for Carrington is changing the relationship between the investor and the investor in a way that makes sense of the whole investor approach. Long term commitment, technical support and nurturing investments should be at the heart of this approach.

Supply and income generation in Northern Ireland

The scale of the challenge in Northern Ireland was recently shown by *Advantage Fundraising Solutions who* reviewed income generation in the Community and Voluntary Sector. The table below shows that community-based organisations are more dependent on grant support from government, Europe and independent Trusts than their regional and national branch counterparts. Three quarters (75.5%) of the total income for those community organisations surveyed came from these three sources.

Box 4 Main Sources of Income for the community and voluntary sector in Northern Ireland (%)

Income Source	National Orgs	Regional Orgs	Local Community/ Voluntary	Average %
Government	30	31	40	33.6
European	1.8	12	15.5	9.8
Private or corporate	6.5	6.5	1.5	4.8
Trusts	5.5	16.5	20	14
Events	17.5	9	6.5	11
Service contracts	5.7	11	2.5	6.4
Gift aid	2.5	1.5	0.1	1.4
Payroll giving	2	0.5	0	0.8
Legacies	9.4	3.5	0	4.3
Street collections	3.6	1.5	3.4	2.8
H2H	1.1	1	0	0.8
Charity shops	1.2	1.2	2	1.5
Business or social firm	0	1.8	2.5	1.4
Large gifts	2.2	1.5	0.5	1.4
Other	11	1.5	5.5	6.0

The research concluded that:

> All too often those in positions of authority, namely trustees, management committees and/or chief executives, lack the knowledge base to be able to take the lead with key fundraising and income generation decisions. While this has always been the case the problem has become more acute with the advent of more business driven fundraising and income generation techniques (AFS, 2004, p. 6).

The report calls for the development of key skills in fundraising, more research into financial management and greater partnership in the provision of financial products for the social economy.

Taxation and the Voluntary Sector

Despite the more attractive taxation environment for social finance funding, SCVO (2002a) has identified important limitations to the impact of fiscal instruments in the community and voluntary sector. SCVO point to the changes that will affect the sector over the two years, which includes:

- Rising unemployment within the sector;
- The reduction in real natural incomes procedures downward pressure on donated giving;
- Shortfalls to the Chancellor’s income putting pressure on indirect taxation such as National Insurance, which would be especially damaging to the sector;

- The benefits of payroll giving and other forms of Gift Aid may not pick up after a slow start up;
- Pensions uncertainties and its impact on provisions made by individual organisations;
- Static or declining central government expenditure.

Clearly, in a Northern Ireland context, the impact of the withdrawal of the Structural Funds after 2006 is, in part, driving the Pathways for Change approach. SCVO (2002b) also showed that 70% of the UK population give to charity in a typical year but less than 10% use the tax breaks available. Lack of awareness and assumptions that it would be technically difficult to operate seem to lie behind the low take up rates. SCVO estimate that every £1 donated to individual charities could actually be worth £1.28. Gift Aid rewarded donations to charity via tax relief at the basic rate of income tax (22%) and the scheme has been progressively widened and simplified since the March 2000 budget. SCVO highlight the need to more progressively pursue payroll giving, deeds of covenant and gifts of quoted shares and securities as a way of responding to the uncertain financial climate highlighted in the analysis above. The full details of the Community Investment Tax Relief are set out below.

Box 5 Community Investment Tax Relief

Community Investment Tax Relief (CITR) is available to individuals and corporate bodies investing in accredited Community Development Finance Institutions (CDFIs), which then in turn provide finance to qualifying profit-distributing enterprises, social enterprises or community projects. CITR will enable an accredited CDFI to offer tax relief as an incentive to investors willing to provide it with patient capital for at least five years. These funds can then be on-lent by the CDFI to borrowers within its target market. The design of CITR draws a distinction between loans made by CDFIs to profit-distributing small and medium-sized enterprises (SMEs) and those to "community projects". The latter category includes both non-commercial activity as well as commercial activity that is small-scale and purely local in nature. Many social enterprises will therefore be included within the scope of that description and thus benefit from the greater flexibility permitted in CDFI transactions with community projects. In particular, when using funds raised under CITR, an accredited CDFI:

- May make a loan of up £250,000 to a community project, compared with a limit of £100,000 for loans to profit-distributing SMEs;
- Is not required to apply the European Commission Hurdle Rate as a minimum interest rate when making loans to community projects, which it must do when lending to profit-distributing SMEs;
- May make an equity investment of up to £250,000 in a community project, but may not make equity investments in profit-distributing SMEs. Full details of CITR can be found at www.sbs.gov.uk/finance/citr/php

Source: Bank of England

CDFIs and wholesale supply

Ainger et al (2002) researched the possibility of a wholesale intermediary for community finance and found that a fully commercial wholesaler, even partly capitalised by government would not be viable in the short-term. However, they found that some form of interim or transitional central funding organisation could provide a valuable catalyst towards a more commercially sustainable future for the CDFI sector. The aim of the wholesaler would be to raise private and public sector financing to on-lend to CDFIs to support their development and growth and increase their scale and impact. Ainger et al set out seven functions for intermediaries.

1. an intermediary with specialist experience in raising private finance could bring a measure of coherence to the scramble for funds amongst CDFIs and give greater coherence to potential investors;
2. an intermediary could also contribute to quality control among CDFIs;
3. the wholesaler might join finance larger loans to community groups, where such loans are too large to be taken into the CDFIs books for prudential reasons;
4. The wholesaler could play an important role in the syndication of tax incentives for investment in CDFIs under the CITC scheme;
5. The wholesaler could reduce the costs of fundraising both for funders as well as the funded;
6. An intermediary might help to keep resources to the sector flowing as the Basel rules on capital adequacy may curtail bank lending direct to CDFIs;
7. An intermediary could provide a more secure source of funds then the grants or subsidised funds, which are neither secure nor likely to be sustained over the long term. (Ainger, 2002, pp. 8-9).

This research is particularly useful for estimating the size of and behaviour within the CDFI market. The table below shows that the estimated total assets in Britain were nearly £700m with a high proportion of assets located in Credit Unions.

Box 6 CDFI Market Breakdown by the Type and Size

Type	**Number**	**Estimated Total Assets**
Social Banks	-	£122m
Credit Unions	700	£215m
Community Development	25-30	£110m
Finance Organisations: Local (Soft) Loan Funds	100	£210m
Community Development: Venture Capital Funds	-	£40m
Total		**£697m**

Source: Based on Ainger, 2002, pp. 11-12.

The key findings of the research are set out in the box below:

Box 7 CDFIs and the Supply of Social Economy Finance

- CDFIs all demonstrate a strong commitment to serving 'unbankable' clients and achieving a community level impact.
- Many CDFIs are small and young but growing rapidly;
- Performance and risk profiles vary widely for different CDFIs but on average they had a loan fund size of £1.5m, a portfolio outstanding of £680,000 and had reached operational sustainability levels ranging for the most part from 5% to 47%;
- CDFIs surveyed do not have a sufficiently developed capital structure or revenue basis for a wholesaler to present a robust credit story to commercial banks for commercial on-lending to the sector;
- CDFI credit worthiness will increase over the next 2-3 years;
- There is interest in the concept of a specialised wholesaler especially in the skills, time and cost advantages it could bring to the sector;
- In the short term there is limited demand or capacity for fully commercial borrowing;
- CDFIs are interested, in the short term, to increased access to concessional borrowing if rates were less than 1-2% over base;
- The study concluded that even in the short-term, a wholesale arrangement could be a useful mechanism to channel funding to CDFIs and start to build a financing source that could be there for the long term;
- The study estimates that the demand for wholesale financing for the next 3-5 years would not exceed £15-20m.

Source: Based on Ainger, 2002, pp. 15-16.

The Ainger et al. study also noted that default rates vary depending on the nature of the target client group. Default rates were low for community development projects and micro enterprises but comparatively higher delinquency for SMEs.

Box 8 Comparison of UK and Default and Loss Rates

CDFI Type	Default Rate (%)	Loss Rate (%)
UK Micro Enterprise	0.44	0.8
UK Social Enterprise	0.8	1.0
UK SME	12.2	8.4
US Business/Micro Enterprise – capital < US$ 2m	9.4	7.6
US Business/Micro Entreprise – Capital $ 2-4m	2.6	4.7
US Housing/Community Service – capital < $4m	2.5	2.3
US Housing/Community Service – capital $4-13m	1.8	0.9

Source: Ainger et al., 2002, p. 20.

Ainger et al also looked at the source of income from 19 CDFIs in the UK and this showed in particular, the role played by area regeneration funds and local authority investment. With the launch of the government's Neighbourhood Renewal Strategy and its explicit commitment to social economy there should be the potential to grow this as a source of revenue for local schemes.

Box 9 Source of Funds for CDFIs

Source of Funds	Amount	% Total Capital	% CDFIs with this source
Bank loan	2,694,000	19%	50%
Other loan	250,000	2%	5%
Government department	2,173,000	15%	42%
Area regeneration funds	1,171,000	8%	44%
Local authority	1,453,000	10%	53%
European funding	857,000	6%	22%
Local and national	227,000	2%	17%
Businesses/individuals	2,203,000	15%	21%
Share capital	2,521,000	5%	45%
Other source	776,000	5%	45%
Total	**14,325,000**	**100%**	

CDFIs have different strategies and goals to increase their sustainability and these include:

- CFDIs that aim to achieve sustainability through steady portfolio growth combined with pricing loans at sustainable rates;
- CFDIs that have or plan to develop non-lending revenue to bolster their sustainability;
- CDFIs that plan to transform to a bank;
- CDFIs that do not see full financial sustainability as an end goal for their entire operation.

Diversifying supply

This section looks at a range of financial instruments and initiatives designed to stimulate social enterprises including future builders, Social Investment Scotland, Community Investment Companies and the Adventure Capital Fund.

Futurebuilders

The Future Builders initiative was an attempt to develop the capacity of community and voluntary sector organsiations to access public sector contracts and services. In the 2002 Spending Review[1], the Government announced the £125 million, one off investment *future*builders, spread over three years to March 2006, to assist the voluntary and community sector in its public service work. *Future*builders is intended to showcase the best of VCS service delivery; to transform the capacity of some individual organisations, or groups or organisations, working together, to engage in service delivery; and to capitalise on the sector's distinctive contribution to service delivery and ability to be creative. It aims to

[1] HM Treasury (July 2002) 2002 Spending Review – Opportunity and security for all: Investing in an enterprising, fairer Britain, Chapter 1, Cm. 5570. Available on the HM Treasury website at www.hmt-treasury.gov.uk .

reinforce the independence of the sector, highlight its potential and lead to a better understanding of its role in service delivery (HM Treasury, 2002).

The principal test for schemes resources by *future*builders will be whether the investment enables an organisation, or group of organisations, to expand or improve their service delivery. Investments are intended to help remove obstacles and enable organisations to modernise to achieve this. It will help tackle the lack of capital investment and development funding in the sector and aims to fund the best ideas, wherever they may be, to create exemplars that inspire and lead to VSS public delivery service.

The fund is specifically aimed at: Existing service delivery organisations that want to do more; Organisations new to service delivery; or Existing and new service providers that want to deliver services in a different way. Moreover, it will assist schemes that are underpinned by six guiding principles:

- Improving service for users;
- Investing in sustainable schemes;
- Promoting greater collaborative working;
- Making the money go further;
- Stretching and challenging organisations;
- Inclusiveness.

The aim of the scheme is to support those organisations working in, or across the fields of: Health and social care; Crime; Community cohesion; Education and learning; and Support for children and young people. The overall funding can be used to buy a wide variety of assets within three broad categories:

- Physical assets (eg. for buildings);
- Intangible assets (for knowledge and skills; an evidence base; and research); and
- Development funding (eg. one off resource spend).

There will be no fixed allocations between the different forms of assets and the fund managers will have flexibility to apportion the fund to best effect, within an overall annual investment plan, approved by ministers.

Box 10 Future Builders: An Investment Fund for Voluntary and Community Sector Public Service Delivery (HM Treasury, 2003, London)

> Futurebuilders will offer grants and different forms of loans, and there will be no fixed allocation between the different types of finance. The emphasis will be on maximum flexibility, so that the specific type of finance can be tailored to suit the needs of individual organisations. The loans culture is new to many in the VCS and, while suitable for some, will not be right for all. The loans element of futurebuilders will be tailored to meet the needs of the sector. There will be no minimum or maximum levels of investment. The fund manager(s) will have the flexibility to invest small as well as large amounts in individual schemes.

Social Investment Scotland

Social Investment Scotland is the initiative promoted by the Scottish Council for Voluntary Organisations to encourage private investment into the Scottish Voluntary sector. It has two purposes.

1. to encourage the private sector and in particular the banking industry to develop favourable and accessible loans and other financial products for voluntary organisations and,

2. to encourage voluntary organisations to a mixed loan and grant rather than grant-dependent culture. It is in effect Community Development Finance Institutions with a more strategic purpose than others in the UK. It will support existing CDFIs but will also attempt to identify and fill gaps in coverage across Scotland (Source: SCVO, 2001, p. 3).

Community Interest Companies

The DTI launched the Community Interest Company (CIC) as a new type of company, designed for social enterprises who want to use their profits and assets for public good. CICs are designed to be easy to set up, with all the flexibility and certainty of the company form, but with some special features to ensure that they are working for the benefit of the Community. They will ultimately report to an independent regulator on how they are delivering for the community and how they are involving their stakeholders in their activities but will require legislation covering a regulator, community interest reports. Subject to parliament the earliest date for registering as a CIC is likely to be early in 2005 and the DTI has published draft regulations and explanatory notes and these are available from the CIC homepage (www.dti.gov.uk/CICS/). A Bill including proposals to create the CIC was published in December 2003.

Box 11 Community Interest Companies (CIC) in Northern Ireland

DETI also launched a Consultation Document on Community Interest Companies in March 2004. This has been linked closely to the implementation of the Social Economy strategy and largely follows the national model above. In particular the document proposes a new legal format for CICs, a regulatory and an approach designed to promote them as a distinct band to encourage social enterprises. The consultation process ends on the 4th June 2004.

Limited Liability Partnerships

Limited Liability Partnerships (LLP) are a hybrid of a commercial company and a partnership. According to Swanson "This model could revolutionise the ability of the voluntary sector and social enterprises to make an impact in regeneration"

(Swanson, 2004, p.10). There are now around 7,700 in the UK as corporate bodies with a legal existence, independent of individual members, which have both collective limited liability and the mutual, co-operative characteristics of partnerships. There is no Memorandum of Incorporation, no Articles of Association and no Shareholder Agreement. The box below shows how they might work in a regeneration context.

Box 12 An example of Limited Liability Partnerships in practice

> Bloggside Regeneration holds a brownfield site, while Bloggside Islamic Community Arts (BICA) needs a workshop to train local people to produce patterned Islamic tiles for the growing UK market. BICA becomes the first ‘occupier member’ and Bloggside Regeneration becomes the ‘capital member’ of the new Bloggside Community LLP, with BICA paying Bloggside Regeneration a peppercorn rent. A new workshop, costing £100,00 is acquired using money from a CDFI, which becomes LLP’s second capital member. The CDFI then receives two percent of BICA’s total revenue: as a ‘capital rental ‘paid for the use of finance, equivalent to those paid for the occupation of land, this payment does not count as interest, making an LLP an acceptable financial structure for strict Muslims. Hence rather than a contract, whereby a debtor organisation pays interest to a creditor, or an investor buys part-ownership of a company in the form of shares, both financer and beneficiary join a partnership whose revenues are then shared. In time, BICA may acquire ownership of the capital asset by making payments over and above the required capital rental. The rental payments will then decline with the outstanding capital.

Source: Swanson (2004), pp. 10-11.

Adventure Capital Fund

The Adventure Capital Fund was established in 2002 in order to pilot a range of approaches to investing directly in independent community based organisations working in disadvantaged areas. The key features of the fund are shown below.

Box 13 Adventure Capital Fund

> A £360,000 Bursary Fund to invest in approximately 20 revenue bursaries, each up to £15,000. The bursaries are intended to strengthen the organisational capacity of an organisation and assist in the development of its investment readiness and a £2 million Patient Capital Fund to invest in 10 capital investments with a ceiling of £400,000. The Patient Capital Investments are designed to establish/strengthen the asset base and increase the scale of operations of the selected community enterprise. The ACF is delivered by a community sector partnership comprising Local Investment Fund (LIF), Development Trust Association (DTA), Scarman Trust (ScT) and the New Economics Foundation (NEF), with the active participation of the Active Community Unit of the Home Office. The designers of the ACF programme have incorporated a number of process elements designed to strengthen the delivery process. The introduction of the Supporters programme, the use of balanced score cards, the exploration of measures of social impact, the development of strong interlocking partnership arrangements and an innovative approach to the evaluation process invests the ACF with a structure has the potential of being both robust and supportive.

Source: Thake, 2003, p. 4.

By the end of March letters offering Bursary grants had been sent to 19 successful organisations and 10 organisations were selected for Patient Capital funding. The successful applicants could be divided into two broad groups: proposals for business development and proposals for physical development. Thake (2003) concluded that evidence from the ACF programme so far has shown that there is a significant demand for a range of Patient Capital products and has begun to identify some of the main characteristics of demand and supply side aspects of the market (Thake, 2003, p. 5).

Sheffield Employment Bond

The Sheffield Employment Bond is an interesting case study on locally based regeneration drawn from www.regen.net. It was launched in April 1999 to raise money from past and present residents of Sheffield, to be spent on local projects to create employment and build social housing. Over £750,000 has been generated:

- To finance social housing and provide work for 60 trainees;
- To enable voluntary and community groups to recruit unemployed people;
- To support a micro-credit loan operated by the local enterprise agency; and
- To support community enterprise.

As many people as possible were approached asking them to subscribe to a bond with a guarantee that their original subscription would be paid interest free after five years. The guarantee would be possible through a financial instrument known as a 'stripped gilt' – a government security with guaranteed repayment of capital and interest. The case study presents an example of a subscription to the bond of £1million, which would then generate £0.75m to be invested in a gilt. At the end of five years this would repay £1m (0.75m of capital and £0.25m interest), so that all subscribers could be repaid their original subscription. The difference between the amount raised and the amount invested (in the effect the interest that investors were willing to forgo) would be spent on projects in the city – which in this example would be £0.25m.

3. Benchmarking profile of supply and demand in other regions

Having examined the range of fiscal and financial instruments available to the sector this section takes a brief overview of strategic analysis and policy that also has relevance for the development of appropriate support mechanisms within Northern Ireland.

Social Enterprise: A Strategy for Success

The DTI Strategy attempted to put in place a high level framework for the development of social enterprises in England. The strategy specifically concentrated on the policies, financial infrastructure and instruments to stimulate business practices in the community and voluntary sector in particular. The quote below sets up the central challenge for the policy.

Box 14 Policy challenge

> At present many social enterprises are under capitalised and struggle to access external finance, particularly when starting up, growing or moving away from grant dependency. Whilst this is often to do with a lack of financial skills, in many social enterprises it is also a result of an understandable reluctance to take on debt. In addition, it is sometimes that investors do not understand the social enterprises market and this situation is exacerbated for those social enterprises located in disadvantaged areas where the transaction costs associated with such investments can be extremely high. (DTI, 2003, p. 64).

The DTI Strategy is especially useful in analysing supply side issues and the table below describes the range of instruments available to grow the social economy in general and social enterprises in particular. As with the Bank of England review it is useful to benchmark the supply and diversity of financial products available to the sector in Northern Ireland.

Box 15 DTI Supply Side Funding Regime

Source	Details
Cooperative Action	New foundation established to support the development of new forms of co-operative and mutual enterprise by giving grants and making loans of between £5,000 and £200,000 in developing or supporting new or existing co-operative enterprises, organisational structures and research.
Community Investment Tax Credit	Encourage up to £1b investment in start up businesses and social enterprises in deprived areas.
Community Development Finance Institutions CDFIs	Independent financial institutions providing capital and other financial support to enterprises in disadvantaged areas
Industrial Common Ownership Finance ICOF	ICOF was set up in 1973 and is a loan fund for employee owned cooperatives and social enterprises. It is supported by pubic shares and is fully self sustaining.
Local Investment Fund	The Fund was established with support from government, Business in the Community and the private sector and by Natwest. Since it was established it has offered 25 loans totalling £29m and has leveraged £15m into community regeneration.
Bridges Community Development Venture Fund (CDVF)	CDVF is a 50/50 partnership between government and the venture capital industry aimed at supplying venture capital was launched in 2002 by the Chancellor. Capital finance to firms operating in some of the most disadvantaged areas in England. More details of the fund can be found at wwww.bridgesventures.com
Charity Bank	The Bank has attracted £10m in exempt deposits and gifts to provide finance and related support to help charities and other organisations develop sustainable charitable ideas.
Business Angels	Business angels can provide investment finance at key stages and often business advice. Social enterprises are potentially a prime recipient of attention from Business Angels who want to put something back in to society.
Community Asset Transfer	The Active Community Unit has been exploring the potential to transfer physical assets such as community centres, parks and redundant building to social enterprise management.
Flexible Clawback	The reinvestment of surpluses generated from government or EU programmes has created accounting problems linked to clawback arrangements. The government are actively considering arrangements to ensure that rules and flexibilities are fully understood and implemented.

Source: Based on DTI, 2003.

A Review of Scottish Executive's Policies to Promote the Social Economy (Scottish Executive)

The Scottish Executive also saw the social economy as a vital instrument in maintaining the long term sustainability of the community and voluntary sector:

> On funding the particular requirements are the need to develop a further, a wider incident of financial products available to and appropriate for social economy organisations so as to allow them to adopt financial arrangements appropriate to their business needs and reduce their dependency on grants (Scottish Executive, 2004, p. 2)

In support of this the Scottish Executive will:

- Allow social economy organisations to include the relevant proportion of overhead costs within their bids for service contracts and identifying any further financial obstacles to development;

- Develop financial capacities of social economy organisations and promote a 'learning culture' that promotes leadership and management excellence;

- Improve existing grant structures by simplifying application requirements and improving the efficiency of payment structures;

- Explore the options for developing funding mechanisms which encourage social economy organisations to accumulate reserves without undermining the requirements of public accounting;

- Develop the asset base of organisations particularly to increase their ability to access alternative funding sources such as loans.

Finance Clusters on a Geographic Basis

One of the recurring themes in the literature has been the potential to build the social economy on an area cluster basis. Neighbourhood Renewal and the Policy Action Team Reports have given an national framework for understanding the barriers and potential of a spatial programme for social enterprise building. The Social Enterprise Coalition (2003) report into the Social Enterprise in the English RDAs and in Wales, Scotland and Northern Ireland highlighted the importance of a bottom up approach, the availability of existing grant support and the integrated framework offered by a zone or local neighbourhood dimension to regeneration policy. It also suggests that financial and knowledge economies can be generated to support the long development of the sector on a cluster basis. The report argued for strategic and local actions to advance social economy solutions to regional growth and these are shown in the box below.

Box 16 Funding and the support for regional planning objectives

- Creation and ongoing support of regional social enterprise networks that can build the capacity of social enterprises in the region through strategic activities;
- Facilitate regional strategies to support social enterprises (linking them into mainstream strategies for SME support) – broker support for other players;
- Fund regional level strategic support actions (awareness, understanding of social enterprise, ongoing data collection analysis, business support, access to finance, sector based clusters, training and procurement opportunities, etc.;
- Fund and support CDFIs investing in social enterprise;
- Fund sub-regional support actions (business support, access to finance, training);
- Fund local support actions (business support, premises, activities linked to regeneration in programmes.

Source: SEC, 2003, p. 11

The New Economics Foundation (2002) also highlights the need for a spatial approach to community finance support, especially for recycling money within the economy and preventing leaks (*the leaky bucket!, p.17)* outside. In particular, local finance alternatives can help to stimulate the *local multiplier effect* by helping to support initiatives that create expenditure within a disadvantaged community itself.

The Financing of Social Enterprises: A Special Report by the Bank of England (2003)

The Bank of England produced one of the most comprehensive and authoritative accounts of social financing in England. The key findings of the research is shown in the box below.

Box 17 Summary of Bank of England Findings on Social Finance

- "Demand for debt finance among social enterprises is limited both by the availability of other, cheaper forms of funding such as grants, and by a cultural aversion to the risks associated with borrowing" p. 1.
- Larger, more established organisations use a range of financial instruments to address cashflow difficulties or to purchase or develop assets;
- Social enterprises are more likely to be rejected for finance than SMEs with possible explanations being lack of available security and personal financial stake; use of organisational structures and grant funding streams with which lenders may be unfamiliar; some element of credit and behaviour scoring; reputational risk to the tender and low levels of investment readiness among some social enterprises.
- There is little evidence of demand for or supply of, conventional venture capital or business angel finance to the social enterprise sector.

One area where the Bank of England research showed evidence of demand was for some form of patient capital.

> The term is variously defined to range from 'investment' grants to products that are structuredas debt or equity, where investors are willing to accept lower, and in some cases uncertain, financial returns in exchange for social outputs (BoE, 2003, p. 1).

Key to tapping into the social investment market is the ability of the social enterprise to describe and account for social costs and benefits and here the methodology of social auditing is encouraged for social enterprises. More will be said about the methodology later in the review.

Encouraging Demand

In order to stimulate demand the Bank of England recommended:

- There is a need to advertise and transfer best lending practice models of lending across the social economy.
- The devolved administrations could ensure that mainstream business support arrangements recognise the particular needs of social enterprises.
- Public sector agencies should expand their funding on research on the feasibility of a business idea.

- Building on existing financial awareness programmes could increase the level of investment readiness of social enterprises.
- A greater emphasis on providing more information and guidance on access to social finance sources.

Linking demand and supply

On the supply side, the Bank of England recommended,

- Increasing the amount of money available to CDFIs specialising in the social enterprise from regional authorities, the private sector and through take up of the Community Investment Tax Relief.
- Develop joint lending (eg. between banks and CDFIs) and encourage co-financing where possible.
- Encourage CDFIs that lend to social enterprises to become approved lenders under the Small Firms Loan Guarantee Scheme.
- It is important to develop a clearer means of distinguishing social enterprises from other borrowers especially by identifying financial indicators specific to the sector.
- A brokerage service could be developed at a local level by an expert in the range of finance services available to the sector. Regionally, there is a possibility of connecting this part of the social economy to People and Place, the DSD Strategy for Neighbourhood Renewal in Northern Ireland.
- Banks could review their procedures for ensuring that broad policy intentions at head office level related to lending to social enterprises are implemented effectively at branch level.
- Specifically the British Bankers' Association could usefully act as a source of information for banks on social enterprises via their website and other communications channels.
- Grant providers, including government, could review the administration of grants so as not to impede the ability of social enterprises to leverage in other forms of finance.

Patient Capital

The main characteristics of patient finance are:

- It is long term in nature, enabling it to be used both for start up and subsequent development funding.
- If structured as debt, it could have capital and interest payment holidays, perhaps to the extent of deferring all capital repayments until the end of the loan. Alternatively, it could be structured as a zero interest loan, analogous to a recoverable grant.
- If structured as equity or quasi-equity, it would involve little ceding of control and would not require an explicit exit strategy.
- However structured, the financial returns would be sub-market, in return for social gains.

The Bank of England review identified considerable demand for this form of soft lending. For example, the Adventure Capital Fund which provides a mixture of grants and long term loans rather than equity, received 38 applications amounting in total to £11.3m to part-fund projects worth a total of £45m despite short applications (see earlier). This form of finance is especially useful for start up or expansion where the planned growth may be out of proportions to the current asset base (Conaty et al., 2000).

One potential source of patient finance for charities is 'Programme Related Investment' (PRI) where the loan will advance charitable objectives and where private benefit will be purely incidental. The Bank of England quote an example whereby a charity established to assist people with disabilities to find employment might for example, choose to purchase shares in a commercial organisation run by and only employing people with disabilities. The success of the company will deliver benefits to all the shareholders but are less significant than the public good deriving from the investment (Bank of England, 2003, pp. 50-51).

Box 18 Bank of England Recommendations in the Extension of Patient Capital

- Government may need to extend the availability of support, such as subordinated matched funding or tax relief.
- The Social Enterprise Coalition could investigate the possibility of establishing a 'social angels' network to match social investors with social enterprises needing investment.
- The results of pilots such as the Adventure Capital Fund and Future Builders would provide more information on how innovative approaches might be applied across government (and specifically at regional level in Northern Ireland).
- Patient finance could be stimulated by sharing best practice and by encouraging larger social enterprises to invest in start up projects.
- In view of the regulatory and cost burden on social enterprises wishing to make a public share offering, the government and the Financial Services Authority could review current regulatory exemptions relating to share issues, in the light of the particular characteristics of social enterprises.
- Social auditing techniques should ensure that they meet the needs of investors and provide a means of benchmarking performance. Source: Based on the Bank of England, 2003.

USCA (2001) carried out a review of the financial needs of SMEs in Northern Ireland and although it concentrated on the for profit sector, it has important implications for the supply of financial products in the social economy, the long term at least. Our own survey of social enterprises revealed a heavy dependence on bank over draft facilities and this was a profile mirrored in the private sector. The report noted that:

> SMEs in Northern Ireland are being encouraged by their banks to reduce their dependency on bank overdraft in favour of more structured lending centred on term loans and asset financing. Northern Ireland banks have not yet achieved UK levels of term loans versus overdrafts (USCA, 2001, p.8).

The research also noted gaps in existing finding supply and suggested three areas in market place development:

1. Early seed capital investment of up to £50k which is most likely to be financed by Business Angels and or family and friends;
2. Seed capital investment up to £250k. In addition to existing technology-related funds, the new Viridian Growth Fund, which will invest up to £250k will help to address gaps in this range;
3. Early venture capital in the range of £250k - £1.5m. The demand for equity is principally from technology businesses and demand rises considerably as these markets grow.

The report concludes by highlighting the need for a cultural change toward wealth creation, entrepreneurship creation, starting with the education system and stimulating more equity intense company structures. Each of these have direct relevance to the long term growth of the social economy in the region and emphasise the need for an integrated strategy.

Delivering the Bank of England Agenda

Shortly after the publication of the Bank of England Review, the Department of Trade and Industry held a conference looking at:

- Developing a better understanding of the social enterprise market;
- Formalising the process of arranging finance;
- Increasing the supply of finance (DTI, 2003).

Box 19 Commercial lending and the social enterprises

> The key to developing a better understanding of the social enterprise market lay in stimulating the private sector and incentivising banks to engage the non standard nature of applications from social enterprises. An area of activity that has particular relevance for Northern Ireland was the need to work with specialist units within banks especially in establishing the commercial value of the sector and alternative partnership arrangements with intermediaries (such as CDFIs) to reduce transaction costs. There is some evidence locally that mainstream banks will debt finance enterprises after credible assessments have been conducted via organisations such as ASPIRE.

In order to support this, the DTI review emphasised the learning and transfer potential of role models that challenge misconceptions among the private finance sector, regional workshops and roadshows and specific training courses organised through the Institute for Financial Services and the British Banking Association.

Strategic support in the Republic of Ireland

A study by TSA Consultancy (2003) into *Social Financing in Ireland* highlighted some of the key barriers to social investment in the Republic of Ireland, which has relevance for policy and product development in Northern Ireland. These included:

- Banking sector regulations making it harder to establish new financial organisations;
- The need for **both** national and local financial sources to develop an appropriate infrastructure for the long term support of the sector;
- Weak support from the state especially in areas such as loan guarantee funds, encouraging the mainstream financial and banking sector to engage social enterprises and tax incentives to promote the flow of resources to the sector;
- Poor skills and awareness in developing financial capacities;
- Lack of policy support, outside training and labour market schemes.

An important point raised in this study was the need for national and local support structures. The purpose of the national structure would be:

- To act as a channel of funding;
- Establish a framework for local delivery and provide technical support in loan management;
- Invest in local delivery structures by ensuring that they meet their core costs;
- Provide loan guarantees for local delivery structures;
- Promote the model with credit unions operating in the area; and
- Establish a low risk social investment fund.

The purpose of the local delivery structure would be:

- Generate support for the local delivery mechanism;
- Assist projects in making loan applications;
- Assess loans and make recommendations to the national structure on loan finance;
- Provide ongoing support and monitor the performance of loans;
- Work with local credit unions; and
- Liase with support and development organisations to seek access to supports for the social economy organisations.

Paul O'Sullivan (2004) from *Clan Credo* pointed out that the main suppliers of social finance in the Republic of Ireland are:

- Credit Unions
- Clan Credo
- Western Development Commission;
- TRIDOS; and
- First Steps.

Clan Credo was established in 1996 to promote social investment and has advanced over €7m to community groups, projects and enterprises. The organisation suggest that this has levered €30m of other funding in the following sectors of activity:

- Accessible transport;
- Accounting software;
- Child counselling services;
- Enterprise centres;
- Environmental projects;
- Local theatre groups;
- Multimedia productions;
- Organic foods;
- Publishing;
- Social housing;
- Sports facilities;
- Special needs projects;
- Technology centre; and
- Youth amenities.

The Western Development Commission (WDC) is a statutory body established by Government to promote foster and encourage economic and social development in the Western Region of Ireland. It operates a €32 Western Investment Fund that provides loans and equity to business and local communities in the area (WDC, 2003). The Fund operates on a commercial basis and aims to become revolving in order to reinvest money back into the region. WIF is divided into three separate funds:

1. A *Venture Capital Business Fund*, which provides loans and equity to high growth enterprises. It has already funded projects in areas such as biotechnology, medical devices, tourism infrastructure and software development.
2. The *Strategic Investment Fund*, which targets flagship projects and initiatives that would have a major impact on the region, such as Knock Airport.
3. The *Local Investment Fund* provides loans to community enterprise groups and has invested in projects such as community facilities, play areas, home help services for older people and enterprise centres.

Benchmarking in the EU and social finance

The EU has produced extensive literature, practice case studies and policy histories of the social economy across Europe (see for example, (http://europa.eu.int/comm/enterprise/). In 1997 the study, *The Social Responsibility of Credit Institutions in the EU – Community Reinvestment and Other Opportunities for the Development of Social Economy Banking,* the consortium of ITT, Malcolm Lynch and EPICEA noted that:

> The national reports examine national banking systems to identify areas of insufficient and inappropriate supply of financial services, particularly in relation to demand that stems from potentially less profitable clients, but exists on a regional or local level. The report states that such a regional or local approach can be found among the traditional banking sector in Europe. However, these elements are more or less unconscious indirect effects of

> their conventional activities, furthermore these are threatened or in constant decline either due to globalisation of competition, or through the new structure of EU banking (ITT, Malcolm Lynch and EPICEA, 1997, p.1).

The report concludes that the Community Reinvestment Act in the United States is a good starting point for a new approach to bank regulation in which contribution to a community or a region becomes a stronger feature of monitoring and assessment along with conventional financial and governance criteria. It also makes the following recommendations:

- The development of a legal basis for non-discrimination on social grounds;
- The creation of a flexible regulation allowing priority to private initiatives;
- Greater social transparency;
- Development of new products and extending opportunity;
- The development of incentives to good practice.

INAISE (1997) highlighted the impact of social economy financial instruments on the creation and maintenance of jobs in several ways:

1. They create jobs that would not have existed otherwise by providing funding in cases where banks demand excessive guarantees or where government programmes impose too many administrative conditions for receiving support;
2. They create sustainable jobs by requiring that all financed projects demonstrate their viability and sustainability in order to ensure their repayment capacity;
3. They create jobs at little cost compared to mainstream Government programmes;
4. They create jobs in areas of unmet needs and pioneer in areas where mainstream banks avoid, such as the environment.

More recently NEF (2002) produced a comprehensive review on *Finance for Local Development: New Solutions for Public Private Action* for the EU and highlighted the following *common mistakes* made by public authorities when starting micro-finance initiatives:

- Trying to develop all the support services internally rather than bringing in the appropriate expertise;
- Trusting established organisations with standardised procedures and ideas;
- Believing only ‘real’ bankers can do it!;
- Offering credit at significantly below market rates;
- Replicating projects that have worked in other regions and often in different market conditions;
- Excessive emphasis on monitoring and accounting for public money with associated monetary and time costs;
- Going too fast and;
- Committing too much in a short period of time.

The table below shows the types of instrument identified in the study and how they are categorised into separate sectors of the market.

Box 20 Instruments and sources if finance for the social economy

Enterprise lending

- Public loan and grant programmes;
- Public refinancing and guarantee schemes;
- Mainstream banks;
- Specialist intermediaries (e.g. micro-credit).

Specialist finance

- Lending to the social economy;
- Housing finance
- Personal finance
- Complementary currencies.

Integrated financial services for the social economy

- Credit and loan cooperatives;
- Community or local development banks;
- Regional venture capital funds.

The report provides an extensive description of financial products, case studies and evaluation of the performance of a range of instruments for the social economy. It concludes by highlighting the following generic lessons in the development of financial infrastructure for the sector:

- Don’t go it alone;
- Respect the market;
- For effective delivery keep it flexible and simple;
- Focus on outcomes;
- Ensure that financial intermediaries are sustainable.

NEF also contribute data and best practice information on finance for the social economy in the UK on www.localdeveurope.org, which also contains useful benchmarking profiles with other member states and resources for development financial instruments and products, especially for new start social enterprises. Their analysis suggested that in 2000 CDFIs controlled capital of nearly £800m, which was broken down as follows:

▪ Loan and micro finance funds	£64m
▪ Social Banks	£490m
▪ Credit Unions	£240m

Evans (2004) looked at the contribution of social capital to the development of the social economy in 8 European Countries and highlighted the importance of networking and sharing skills to the development of the economy. However, the study also highlighted the tension between the development of the business aspect of the enterprise and its social objectives. In particular, there was the potential for mission drift and the dilution of positive social capital outturns as the organisation become concerned about profitability and sustainability. The box below provides a useful summary of research findings and the implications for policy development in Northern Ireland.

Box 21 Social capital and the development of a local social economy

Research findings
Social enterprises are networked, not always with other social enterprises, to form bridging social capital
Social enterprises were in competition mostly for public sector funding
In more isolated rural locations networking with the broader voluntary sector was important
Networking of clustered social enterprises often required bridging social capital in place in order to be effective and sustainable
Intermediary agencies or development organisations were important in facilitating networking
Social capital strengths in an organisation were important to its reputation and credit worthiness
Internal social capital and external networking were especially important at times of organisational or project ‘crises’
Social capital is *appropriable* in that clusters of enterprises can lead to the development of new projects and organisations more rapidly than in places were clusters are weak or non-existent
Membership is important in formalising social capital participation in an organisation
Networking can help to reduce transaction costs

4. Lubricating the market

This section looks at the systems and processes that have helped to make the market operate effectively. Clearly, much of the literature is concerned with making the financial product and services market work more efficiently for social enterprises.

Opening access to information

A range of intermediary organisations have invested in the production of technical advice, guidance and information. Social Enterprise London has produced a practical resource for business advisers, trainers, social entrepreneurs and local communities who wish to use business models to achieve social aims (SEL, 2003). SEL has also produced resources such as legal forms for social enterprises and development programmes for different sectors including housing, childcare and recycling (www.sel.org.uk).

Bristol City Council also invested in preparing accessible information on sources of funding for social enterprises. Information is held on multiple formats, updated regularly and has an emphasis on income streams and who and where to contact financiers. Similarly Co-active (The Cooperative Development Agency) has produced extensive technical support material especially for start up businesses (www.co-active.org.uk). For instance, the box below is based on Co-active publications and the range of supply products available to new start social enterprises and cooperatives in particular.

Box 22 The supply of investment finance

Source	Purpose	Information
Own capital	This emphasises the margin which entrepreneurs can valorise their own assets such as property and equipment	
Outside investors	A range of sources are emphasised including: the British Venture Capital Association National Business Angels Network	www.bvca.co.uk www.bestmatch.co.uk
Bank finance	Overdraft finance Loan finance	
Other finance	Leasing (eg. vehicles) Hire purchase factoring provides start up enterprise with finance against invoices that customers have not yet paid. Stock finance where cash is raised against the value of the stock held by the company.	
Security for moving	Securities might include a Personal Guarantee, third party guarantee from a Small Firms Loan Guarantee Scheme (SFLGS). The Small Business Services Business Life provides an additional information resource on this work.	www.businesslink.org

Source: Based on Co-active (2002).

Skills in Financial Management

In formalising the process of arranging finance the DTI highlighted the need to develop better grant-giving policy and in particular the need to differentiate funding streams were cocktail arrangements are possible for some social enterprises (DTI, 2003). For example, it was suggested that RDAs, charitable trusts and investors could work more closely together to identify their respective inputs with the project. The RDAs could fund projects such as feasibility studies, charitable trusts could focus on core funding the social mission whilst CDFIs or the banking sector could support tradable aspects of the organisations work. However, the lack of skills in brokering and managing these integrated investments is a particular obstacle to the development of this agenda.

Box 23 East End Micro Credit

East End Micro Credit started in East London in 1998 as a network to help increase access to finance for the self-employed. The group recognised the need for two types of partners: technical aid providers to support business mentoring, loan support, outreach and capacity building; and loan fund partners who provide the finance and administration. Many of their loans involve peer group lending whereby groups of between 4-6 people train together and learn business basics for two months. Individual loan applications are sanctioned by the rest of the group and assisted by a facilitator but failure to repay defaults the entire group and no further loans can be made. Since 2000, 50 peer groups were formed involving over 250 men (13%) and women (87%) and over 150 loans have been made. As a result 130 new self employed micro businesses have been established with only 2 defaults to date.

Source based on Bristol City Council 2003, p. 45.

There is in particular a shortage of professional finance staff working in social enterprise organisations. Many social enterprises need funders to provide the financial skills they lack and often lack information about the range of types and sources of finance available, meaning that it is difficult to assemble the mixed finance packages that are often required. This is because finance organisations operate in isolation and there are a lack of intermediaries able to broker deals on behalf of social enterprises (DTI, 2003, p. 7).

The report calls for better organisational working amongst ‘deal makers’ in various finance organisations and argued about a formal system of referrals and co-ordinated information would help to lubricate this part of the market. The report also highlighted the need for charities to operate a ‘double-line’ to fully account for income and expenditure related to tradable and purely social aspects of the organisations work although this is a structure adopted by a number of community and voluntary sector organisations in Northern Ireland (via separate trading arms).

Box 24 Technical Assistance Fund

> A network of social business angels could be established to support the sector especially in widening the use of equity finance and innovative strategies for investors. If CDFIs are to undertake this role then they should: receive funding to cover the full costs of helping social enterprises present themselves to banks; produce a web-based self-diagnostic tool for social enterprises to help them to identify their finance needs and services; scale up the financial awareness training pilot to added investment readiness of social enterprises (DTI, 2003, p. 5).

Increasing the supply of finance requires particular institutional skills and faces legal obstacles. For example, the report highlighted that there are restrictions in Community Investment Tax Relief (CITR) that mitigate against lending on certain groups or geographically where poverty is found adjacent to wealth, certain thematic groups or even organisations that deliver public services. The key recommendations from this part of the conference that have particular relevance to Northern Ireland were:

- Feasibility and technical assistance funding for borrowers along the lines of the US model of government support for technical assistance through banks and more especially via CDFIs.

- Continued strategic support is required to enable the CDFI sector to work more closely with the banking sector on new products.

- The continued assessment of Community Investment Tax Relief, which could be carried out at a regional Northern Ireland level in order to monitor the flow of financial inputs and impacts vis-à-vis the rest of the UK.

Social Entrepreneurship

The Global Entrepreneurship Monitor (GEM, 2004) showed that 6.6% of the population has engaged in some form of activity that has community or social goals at its heart and this is higher than mainstream entrepreneurial activity at 6.4%. Northern Ireland was not included in the review, which was based on a survey of 22,000 adults aged 16-64 in the Great Britain in 2003. The GEMs report identified the Phoenix Fund and its objective on skills and leadership as a driver for entrepreneurial activity and showed that it was most concentrated in the education, health and recreational services. It also points out that these are areas that are strongly allied to public sector service provision and which can in turn develop mixed revenue streams to sustain organisational development and investment in people and their management competencies.

Sourcing Financial Support and Advice

Smallbone et al. (2001) showed how many successful social economy businesses started on shoestring budgets with soft loans providing valuable start up resources. However, their research also showed that:

> Even social enterprises that are committed to commercial viability for at least part of their operations often show little tendency to access business advice from commercial or other formal mainstream channels, particularly at or close to start up (Smallbone et al, 2001, p. 38)

The Smallbone Review was especially critical of Business Link Services; their understanding of social enterprises and the distinctive services that social enterprises require. Only 25% of surveyed Business Links claimed to have a specific policy towards social enterprises and only 9% had a social enterprise database.

Business Link carried out its own review of services to the social economy which highlighted the need for an integrated programme to support the sector that include:

- Outreach services concentrating on rural drop in facilities, presentations in schools, contact with other agencies and publicity; Gateway Services for handling enquiries which focuses on initial referrals and systems for tracking external referrals. Prestart services are required which are tailor made to new organisations and which can help to build network relationships between groups in the sector.

- Specialist services and skills bespoke to social economy enterprises.

- Interagency referrals on a planned and integrated basis (Business Link, 2001, pp. 23-24).

However, the Smallbone review also highlighted the need for a wider range of services in:

- Accessing finances;
- Preparing funding bids;
- Developing knowledge and expertise to access funding sources;
- New forms of grant finance designed to start up or growth of social enterprises;
- The need for loan finance to aid start up;
- The need for local delivery mechanisms to ensure that loan finance is effectively used within communities where it is needed.

The Skoll Centre at the Said Business School

The Said Business School at Oxford has just set up the Centre for Social Enterprise, which aims:

- To provide a global forum to debate and move forward the social enterprise agenda;
- To provide a resource centre and key role in the international network in this area;
- To undertake research to inform the future development of social entrepreneurship;
- To nurture tomorrows social entrepreneurs by creating a unique MBA programme for existing entrepreneurs.

The Centre has established NESsT (the Non-profit Enterprise and Self-Sustainability Team) which aims to support non profit organisations in the development of income generation activities, support longer term financing, develop skills and ideas and measure performance against agreed indicators. The development of this global centre of expertise also focuses attention on what technical support is available at a regional level in Northern Ireland.

5. Measurement and social auditing

This section looks at the issue of measurement and evaluation in the social economy. In particular, the literature points to the need for more appropriate accounting systems around social enterprises and presenting the real value added of the economy and the diversity of activity within it.

Social Auditing

The New Economics Foundation (NEF) has been involved in social and environmental accounting from its beginning and helped to establish ACCOUNTABILITY, which is in the Institute of Social and Ethical Accountability (www.accountability.org.uk). ACCOUNTABILITY has been developing standards in the field of sustainability reporting which puts stakeholder engagement at the heart of the process. Methodologies such as SIGMA (www.projectsigma.com) and the Global Reporting Initiative (www.globalreporting.org) describe templates for businesses to account and report for their social, environmental and economic performance.

Social Return on Investment (SROI) has been developed by NEF to integrate social and environmental measures into formal financial reporting systems. The technique was developed by REDF which is a charitable foundation whose mission is to help people move out of poverty (www.redf.org) and the six stages to the model are shown in the box below.

Box 25 REDF Six Stages to Calculating Blended Return

Stage 1: Calculate Enterprise Value
Discounted cash flow analysis of the business performance.
Stage 2: Calculate Social Purpose Value
Discounted cash flow analysis of each enterprise's socio-economic results. Socio-economic factors are identified that produce direct, demonstrable cost savings and revenue contributions that are associated with individuals' employment in a social purpose enterprise. These values are public sector savings
Stage 3: Calculate Blended Value
Add the two together and subtract any accrued long-term debt, to derive the enterprise's Blended Value.
Stage 4: Calculate Enterprise Index of Return
Enterprise Value is divided by the investment to date to derive this index.
Stage 5: Calculate Social Purpose Index of Return
Social Purpose Value is divided by the investment required to date.
Stage 6: Calculate Blended Index of Return
The Blended Index of Return compares the Blended Value of the social purpose enterprise to the total investment to date. It shows the return on both business and social mission activities.

Source: NEF, 2003, p. 11.

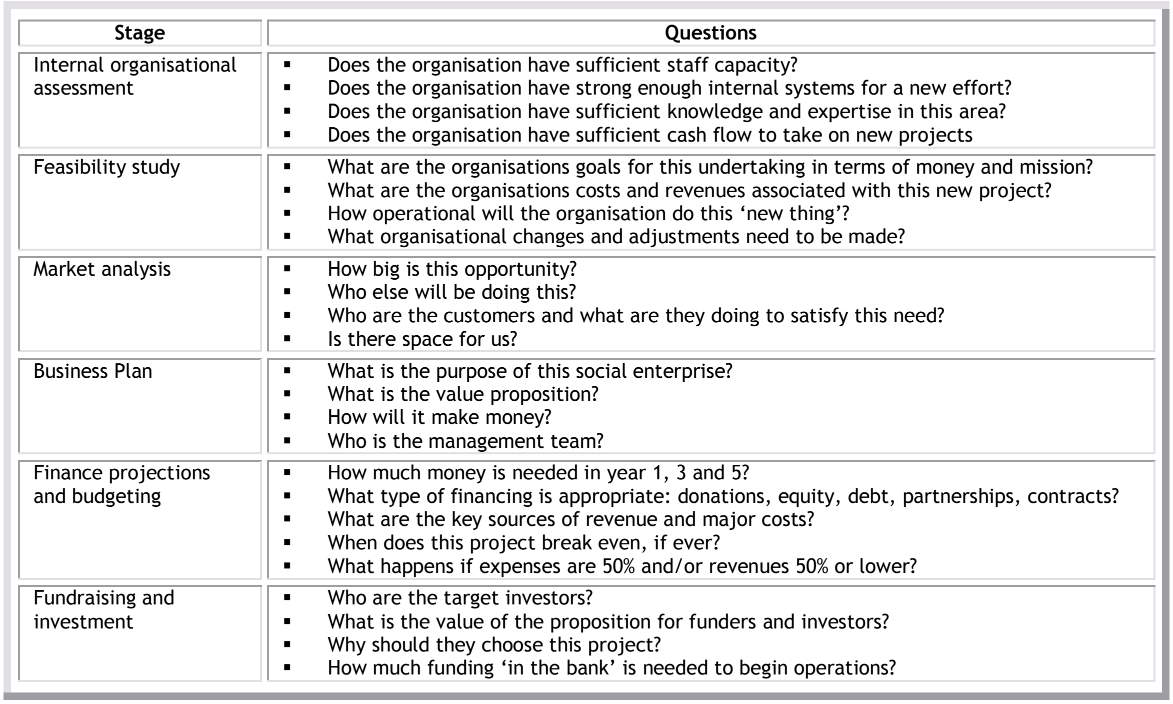
So for example, REDF applied these stages to one of their investments – The Rubicon Bakery, a wholesale bakery that produces cakes and tarts, while providing quality entry-level jobs for disadvantaged community residents in the food service industry and derived the following values:

- Investment - $1.8m
- Enterprise Value - $10.8m
- Social Purpose Value - $19.4m
- Blended Value - $29.6m
- Enterprise Index of Return - $$6: $1
- Social Purpose Index of Return - $10.7: $1
- Blended Index of Return - $16.4: $1, Source: NEF, 2003, p. 11.

Social enterprise planning

Social Enterprise Associates (2003) provide guidance on business planning for social enterprises but warn that, “the best strategic choice of your organisation may NOT be to undertake a social enterprise activity. Not all efforts are successful. 80% of new businesses fail in their first five years and data shows small organisations have been less successful than large organisations at revenue generating programmes” (Social Enterprise Associates, 2003, p.1). They provide a useful template for evaluating the feasibility of developing a social enterprise including the risks, uncertainties and opportunities in assessing organisational and market capacities. This is shown in the box below.

Box 26 Assessing the feasibility of social enterprise development



Stage	Questions
Internal organisational assessment	▪ Does the organisation have sufficient staff capacity? ▪ Does the organisation have strong enough internal systems for a new effort? ▪ Does the organisation have sufficient knowledge and expertise in this area? ▪ Does the organisation have sufficient cash flow to take on new projects
Feasibility study	▪ What are the organisations goals for this undertaking in terms of money and mission? ▪ What are the organisations costs and revenues associated with this new project? ▪ How operational will the organisation do this ‘new thing’? ▪ What organisational changes and adjustments need to be made?
Market analysis	▪ How big is this opportunity? ▪ Who else will be doing this? ▪ Who are the customers and what are they doing to satisfy this need? ▪ Is there space for us?
Business Plan	▪ What is the purpose of this social enterprise? ▪ What is the value proposition? ▪ How will it make money? ▪ Who is the management team?
Finance projections and budgeting	▪ How much money is needed in year 1, 3 and 5? ▪ What type of financing is appropriate: donations, equity, debt, partnerships, contracts? ▪ What are the key sources of revenue and major costs? ▪ When does this project break even, if ever? ▪ What happens if expenses are 50% and/or revenues 50% or lower?
Fundraising and investment	▪ Who are the target investors? ▪ What is the value of the proposition for funders and investors? ▪ Why should they choose this project? ▪ How much funding ‘in the bank’ is needed to begin operations?

Source: Social Enterprise Associates, 2003, pp.1-3.

BRIAN: A diagnostic tool for social finance needs

Peter Lloyd Associates have also developed a diagnostic tool for understanding the position and development needs of social enterprises and co-operatives. In attempting to establish the dimensions over which social enterprises should be best measured consistent with their dual focus it was decided that two normative logics would need to be applied.

- Business logic (3 scales); and
- Social purpose or solidarity logic (2 scales).

To a significant extent these are counterpoised. The business or market logics are those that if applied rigorously to the relevant activity would in most cases have determined that the good or service be not offered in the first place in the particular place or for the particular client group. It is the application of the social purpose logic that draws subsidy or offsets factor costs that enables the organisation to perform its role as a social enterprise in a context of market failure.

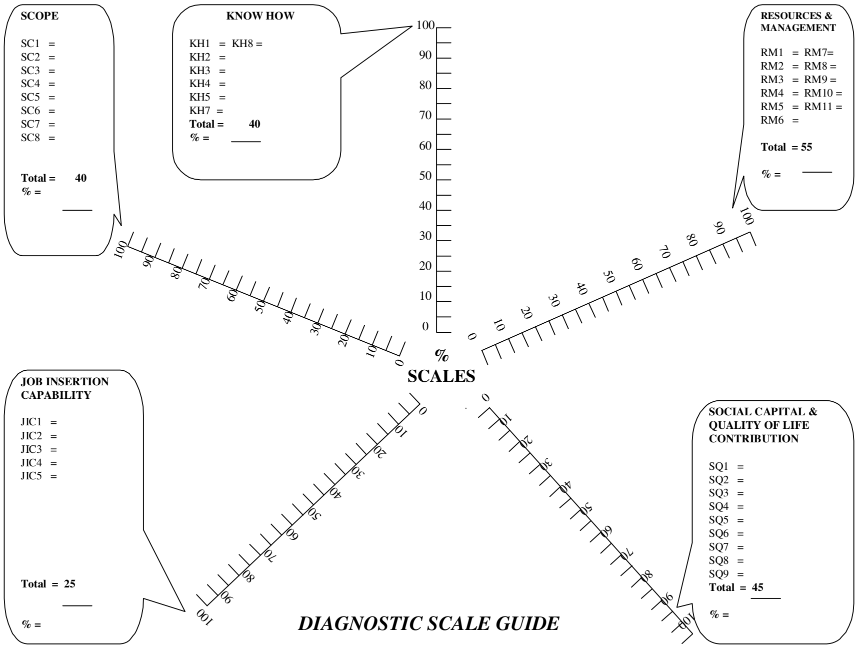
From the opposite perspective, the application of business acumen within the overall context just described is appropriate to ensure that the best possible efficiency is applied to offer the good or service within the available resources. In the end all that the instrument is claiming to explore is how a sensible allocation of scarce resources should be applied in accordance with the mission of the social enterprise. The “best” social enterprises should have an appropriate mixture of both logics. Precisely what this is can only be determined by engaging the organisation itself in a process that enables it to make a judgement. The figure below shows the chosen radar plot and the five scales from which it is constructed. On the upper half of the diagram are the three scales that explore dimensions of the social enterprise as a business activity. These are:

- *Scope* – this explores the market context in which the enterprise operates and its positioning in relation to that marketplace;

- *Know how* – this looks at the knowledge base of the organisation and looks to see who this is applied to aspects of business performance;

- *Resources and Management* – this looks at the assets, cash and credit and physical resources available to the enterprise as well as some key features that show how the enterprise is organised to define and deliver its objectives.

Box 27 BRIAN Assessment of social economic enterprises


SCOPE
SC1 =
SC2 =
SC3 =
SC4 =
SC5 =
SC6 =
SC7 =
SC8 =
Total = 40
% =
KNOW HOW
KH1 = KH8 =
KH2 =
KH3 =
KH4 =
KH5 =
KH7 =
Total = 40
% =
RESOURCES & MANAGEMENT
RM1 = RM7=
RM2 = RM8 =
RM3 = RM9 =
RM4 = RM10 =
RM5 = RM11 =
RM6 =
Total = 55
% =
JOB INSERTION CAPABILITY
JIC1 =
JIC2 =
JIC3 =
JIC4 =
JIC5 =
Total = 25
% =
SOCIAL CAPITAL & QUALITY OF LIFE CONTRIBUTION
SQ1 =
SQ2 =
SQ3 =
SQ4 =
SQ5 =
SQ6 =
SQ7 =
SQ8 =
SQ9 =
Total = 45
% =
100
90
80
70
60
50
40
30
20
10
0
%
SCALES
DIAGNOSTIC SCALE GUIDE

The two scales that examine the social purpose and solidarity aspects of the social enterprise organisation are in the lower half of the diagram are. These are:

- *Job insertion capability* – this scale looks at the role that the enterprise sees for itself in helping excluded people into work or least some form of economic activity;
- *Social capital and quality of life contribution* – this represents the role that the organisation sees for itself in generating social and cultural capital for its locality or client group.

The instrument is made up of six sections and a total of 49 questions. These questions then elicit responses from which agreed values are recorded. There are a total of 68 opportunities to record responses with response opportunities are made up to two main types; 41 enable the creation of the radar charts and a further 27 built up a typology of the population of social enterprises as a whole.

Social capital measures

Community Evaluation Northern Ireland has developed an indicator template that aims to factor in the net social worth of the community and voluntary sector. Using the concept of social capital the model recognises that conventional indicators of economy, efficiency, effectiveness and equity are still important in benchmarking organisational performance. However, they also highlight the need to construct measures of added value on:

- Individual capital
- Organisational capital
- Community capital
- Civic capital

For each level there are a series of social capital indicators, which are built into agreed monitoring and evaluation indicators. Ultimately, the objective is to assess project or programme intervention on bonding, bridging and linking social capital (see, www.ceni.org for a full copy of the report).

6. Implications for social finance in Northern Ireland

The aim of the literature review was to highlight the themes relevant to the development of an efficient market for financing the social economy in Northern Ireland.

- The literature showed that the supply of financial products and resources was not necessarily a problem but the asymmetry between supply and demand was. The supply of resources was characterised as a 'jumble' with the lack of clarity on the consumer side about the products available and how to access them.

- Linked to this, there is a lack of skills and awareness about accessing start up, investment and growth finance, and it was noted that some agencies have invested in technical assistance to develop financial management competencies within the social economy.

- It has also highlighted that mainstream financial resources and business support services should be used as fully as possible to support the social economy. Here, there was an emphasis on joint lending, brokering investment, support with grants and loans, and improving the investment readiness of social enterprises.

- Existing and emerging financial instruments need to be more effectively employed in the social economy. The impact of Community Investment Tax Relief, Community Asset Transfer and the Small Loans Guarantee Scheme need to be better understood and applied locally.

- *Centres of Excellence* and the development of a learning culture within and between businesses could be explored further especially in the context of emerging social enterprises in Northern Ireland.

- Shifting community and voluntary sector organisations from grants to loans will be a formidable challenge, but a crucial one, especially in the context of the social investment model. The Scottish Executive highlighted the need for social enterprises to keep a proportion of their overheads from grants, improving the efficiency of grant structures, and rules and allowing voluntary sector organisations to accumulate reserves.

- There does not seem to be a short tem interest in wholesale finance for the social economy although there does seem to be an opportunity to develop patient finance for start up and growth lending.

- There is a strong interest in the development of social accounting models and evaluation systems.

- The overarching implication is the need for a clearly differentiated and hierarchical supply of financial products from grants; to soft loans; patient capital loans; equity finance and a better skilled consumer environment to make the market work more effectively.

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