Social Economy Finance in Northern Ireland

Working Paper 4: Regional and global benchmarking

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1. Introduction

This report has been prepared by Peter Lloyd who reviews the experience of the English Regional Development Agencies and the devolved administrations in the UK and by Belden Daniels and Lisa Hagerman, who looks at recent developments in social economy financing in the US. The report is primarily designed to benchmark experience in Northern Ireland with other areas and to compare and contrast provision in the region with other areas.

The bulk of the research reported in the first part of this paper was carried out between August 2002 and March 2003 under a contract for the Social Enterprise Coalition. The purpose was to examine, as a benchmark for future work, the extent to which the English RDAs were engaging with social enterprise. The project was taking place at the very beginning of the UK government's newly installed central policy to support social enterprise. Indeed it was begun in the same week that the government paper Social Enterprise: A Strategy for Success was published. A year has passed and the second part of the paper provides an opportunity to re-visit the findings and to take the pulse of the new policy initiative. This second exercise has been done in a less formal way through telephone contacts and web search but the findings, though tentative, offer some interesting areas for debate.

2. The Struggle to Position Social Enterprise in the RDA Policy Environment

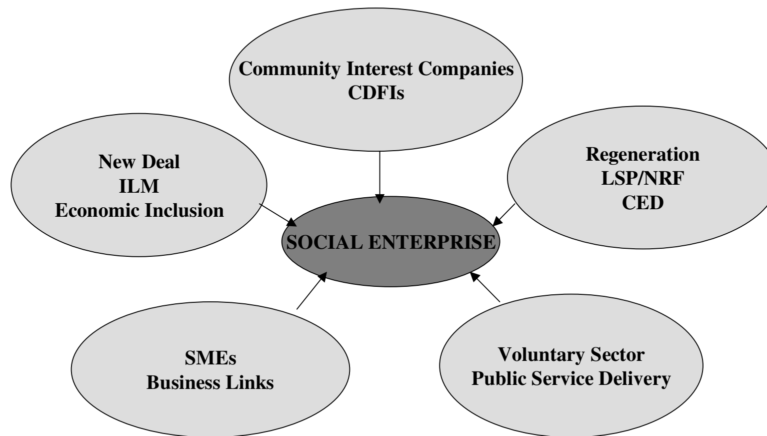
As Figure One shows, social enterprise lies at the intersection of a wide range of cognate policy areas for which the RDAs have responsibilities. It has, however, colonised some of these more readily than others. Social enterprise is embedded differently from region to region and there is no evidence of some one-size-fits-all model. The major difficulty encountered by the RDAs in bringing social enterprise into the mainstream a year ago, despite the enormous impetus given by the publication of Social Enterprise: A Strategy for Success, was revealed as the struggle for clarity. Chief Executives and Directors of Strategy found it difficult to grasp what precisely the often interchangeably used labels social enterprise and social economy meant. They were (and as we shall see later, still are) struggling to put a value on these sorts of activities as against other more easily measured elements of their central target driven portfolio. The fact that there was, and still is, a lively debate taking place within the sector itself simply adds to the confusion.

Fitting social enterprise into the RDA mission

The formal brief for the RDAs sees them as being responsible for "restoring, promoting and sustaining" their regions. This already draws them into the combined complexities of both the economic competitiveness and the social inclusion agendas. Administratively they also find themselves in the middle caught between the disciplines of new public management - with government approved regional economic strategies and centrally prescribed targets - and those more wide-ranging pressures coming up from directly within their own regions through their Boards and from increasing Regional Assembly scrutiny. This leaves them with a tricky balancing act to perform under any circumstances.

A year ago the introduction of social enterprise into the revised Regional Economic Strategies was made more challenging in the face of close central regulation. Even where the RDAs were convinced of its merit they faced problems simply finding space for social enterprise without an accompanying target. There is some recent indication that the central versus local dilemma is being addressed, however. Moves are afoot both to simplify the central target structure and to allow for more regional variation. It seems that the truth may have dawned that regional difference is a reality that cannot easily be addressed by centrally set floor targets however important that may be for accountability purposes.

Box 1 Regional policies and social enterprises



As if this were not challenging enough, at the end of 2002 the RDAs were going through a period of internal review and reconfiguration. There was, for example, a high turnover among Chief Executives as some of those initially appointed to launch them moved on. The second rounds of Regional Economic Strategies also drew them into intense rounds of consultation and saw many change their organisational structures. The "single pot" was still being bedded in as their core, regionally owned, financial instrument. There was also, it has to be said, a sense of world-weariness, as the flood of new initiatives from the centre showed no sign of lessening and social enterprise was, for many, just another bright idea from government.

These internal pressures and conflicting loyalties are important in understanding the way the English RDAs took up the new policy initiative for social enterprise in 2002-2003. In the six months prior to the study the "bottom up" pressure from within the regions, from the sector and from the DTI with its new social enterprise brief rose sharply in response to the show of interest by government. But no central targets were set for social enterprise and, while most of the regional strategies signalled support for it, there had not been sufficient time and staff resource to go from aspiration to detailed plans of action. A number of chief executives indicated that what made it particularly difficult was that they found themselves drawn into the higher transaction costs of dealing with a complex and often internally divided regional Third Sector.

What the earlier study revealed, then, was the early days of a struggle by the RDAs to deal with some of these pressures – taking social enterprise on board but struggling to understand it and to find the corporate resource to get real policy seriously under way. What the RDAs seemed to want to help

them engage with the fast moving social enterprise agenda was the answer to a series of what they saw as very straightforward questions.

- What is social enterprise/social economy?
- Is it fad or core future business?
- Where does it fit in an RDA?
- What weight should be given to it?
- What will give best returns for RDA effort?
- Who can be depended to help us?
- How will we know what works?

A year on it will be instructive to see how far they seem to have been able to get the answers they needed. We can take the questions in turn.
How to Define Social Enterprise and Find Space for It?

Competing Discourses

Despite the difficulties, the earlier study showed all the RDAs to be generally supportive of the government strategy for social enterprise. No RDA rejected the proposition. The difficulty lay in what might be described as the pick 'n mix of different social enterprise discourses that confronted them. At least four dimensions of this were jostling for their attention:

- Trading social enterprises as the focus for attention;
- CDFIs and new financial instruments as a critical instrument;
- European policy drivers for "bottom up" and local economic inclusion;
- Co-operative, CDA, and democratic management initiatives as the ethos;

The DTI document presented a clear focus of interest on what, to some, seemed the narrower agenda for trading social enterprise. This appeared closer to the "not-for-profit" approach associated with social enterprise in the US than was the case in the emergent movement for social economy approaches in most regions. Trading social enterprises were seen as operating in a relatively normal marketplace and the need was to develop a series of new financial instruments and legal formats to assist them to flourish and be better businesses. This was entirely consonant with what had been a growing interest in "patient capital", smart loan funds and micro- and mutual credit initiatives that had been emerging long before the advent of the DTI document. There was also long-standing pressure for more appropriate business forms by a sector that had been seriously constrained by existing company law.

A strong constituency of interest had also built itself up around a second group of discourses that was derived from European "bottom up" and local partnership policies. This positioned social enterprise as a vehicle to generate enterprise and create jobs in deprived localities as a tool to foster

economic inclusion. Here the business case was less vital than the opportunity to engage local people and partnerships in whatever enterprising activities were available in the nation's most deprived neighbourhoods. It was critical to this discourse that European funds should be available to help generate local (or community) enterprise in anticipation of any real revenue expectations in the short run.

The third constituency engaged in the debate about social enterprise as the DTI initiative was launched was one with a long-standing place in economic discourse and with historic political connections in the labour party. The co-operative movement could lay claims to being the originators of "market led but value driven" enterprise in the UK from the Rochdale Pioneers onwards. More closely associated with a principled position on "common ownership" for workers and small producers and with mutual forms of credit and financial support, this group was close to the core of the DTI venture and highly committed to the trading agenda. It also had a national network of Community Development Associations (CDAs) that was in the process of re-positioning itself after a long period of engagement with democratic forms of enterprise management.

Differential Take-up by the RDAs

The social enterprise venture was then being launched onto a regional terrain that would see one or other of these competing approaches turning out to be more attractive to established interest groups. Some regions majored on one, some on others. London, for example, was the strongest promoter of the trading social enterprise and CDFI approaches per se and but with footprints in the other areas. Close to government and with close contacts in the Co-operative movement it continues to be the strongest advocate of the DTI version of social enterprise strategy.

The East Midlands took up the trading social enterprise and CDFI agendas but also advocated a strong focus on the European-informed model of economic inclusion through its Local Alchemy - reviving deprived localities through social enterprise solutions. Debates between these London and East Midlands perspectives continue to be a lively source of debate in the Social Enterprise Coalition – a body set up to bring the sector together in support of the DTI initiative and subsequently grant aided by the Small Business Service though the Phoenix Fund .

European assisted regions like the North West (particularly Merseyside) and Yorkshire and Humberside, the West Midlands and to a lesser extent North East, came from well developed area-based social or community enterprise policies planted by a history of ERDF support. These continue to draw down European funds and, for the present, can support a wider range of activities at all levels through the benefits of external funding. There is a tendency for the platform of activity in these regions to be associated more with the wider social economy than with what they see as the narrower focus on

trading social enterprises. The concern here is, however, that after 2006 the present spread of activity will be unsustainable in its present form as the European funds come to an end.

The more rural regions in the East and South West were for the most part unable to tap Objective Two European funds for area based programmes though they were beneficiaries of LEADER and ESF funds through programmes like ADAPT and EQUAL. The new initiative did, however, give them the opportunity to apply their long-standing experiences of co-operative action in agriculture and rural service provision to the emerging agenda for social enterprise. With these regions there is a strong tendency to focus on the creation of intermediary support structures to assist a population of mostly dispersed small enterprises to get business support, finance or better access to public contracts.

Social enterprise did not, then, come to the RDAs neatly pre-packaged. It came as a series of different propositions on how to run businesslike enterprises with a social purpose and a series of competing lobbies anxious to tell them the right way to go. Differential geographies and economic and political antecedents saw the regional “take” on the emerging social enterprise agenda vary widely from region to region. For the RDAs struggling to establish themselves against hard government targets, there simply was too much “noise” around a year ago for them to try to engineer the sort of commitment and resource that was needed. What they were, however, able to do was to begin to think things through and put strategies into place.

Where Does Social Enterprise Fit Strategically and with What Weight?

The key task of the RDAs is to act as strategists and enablers. Consistent with this, all reported a year ago that they had a strategy for social enterprise in place. Mostly, however, it was bedded into a set of pre-existing organisational architectures and an already prescribed policy framework. Some regions had a clearly discernible policy in play but others had, in reality, found little or no room for social enterprise beyond broad statements of support.

A critical measure of the degree to which an organisation is seriously committed to some new venture is whether or not it has created space for a product champion. Only two of the RDAs could identify them. In one other a dedicated section for social enterprise had been established. For the most part at this early stage, social enterprise appeared as a part-task carried out by members of the social inclusion or sustainable development team.

An examination of the documentation showed three broad types of strategic activity to be emerging with the RDAs usually operating over two or more of them. These were:

- building a suite of enabling structures to support social enterprise;
- adopting a pump-primer, gap filler, broker role (particularly in financial instruments) to get social enterprises started; and
- providing grant aided support for area based community enterprise;

The box below summarises the findings.

Box 2 Strategic approaches to social enterprises

Building a suite of enabling structures to support social enterprise

All the agencies interviewed understood that a primary role for them was to create conditions in their regions for the growth and development of social enterprise. But at this stage there were differences in the degree to which these sorts of structures had been articulated in practice. In part these differentials reflect the stage that had been reached in building links with the social economy or social enterprise sector in the region concerned. Where links with the wider sector have come into place early and with relatively low transaction costs, support strategies tend to have crystallised more quickly. In London, for example, the London Social Economy Task Group in which the LDA is a key player has been able to set out an agreed strategic framework in *Time to Deliver: A Social Enterprise Support Strategy for London.* Similarly, in the East Midlands and the Merseyside Sub-Region within the North West there is good progress to report on the creation of a comprehensive supporting infrastructure alongside Social Enterprise East Midlands (SEEM) and the Merseyside Social Enterprise Task Group respectively. In the South West the RDA has recently funded Regional Infrastructure for the Social Economy (RISE) as a body to put in a comprehensive support structure. In Yorkshire and the Humber, within a sub-regional structure, a comprehensive strategy for support is coming into place.

Adopting a pump-primer, gap filler, broker role

Perhaps as a preliminary measure while a more worked through strategic support framework was under discussion, or in one or two cases by actual choice of option, there is evidence of a role that privileges standing back and seeking to be helpful in filling gaps where they can be identified. There are issues here of the resources available to act more widely where the RDAs operate from different financial platforms. Some have to arbitrate between varying calls on resources against limited funds. The availability of European funding is also a key variable here. Where RDA funds can match ERDF and lever more output from the same input of their own resources they can clearly do more. For agencies with limited access to funds and ERDF match funding (EEDA and SEEDA, for example) gap filling and pump priming may well be the rational option in the short term. One obvious route was an engagement with the CDFI movement to get loan, micro- and mutual credit funds up and running.

Area based community enterprise support

This dimension of strategic focus was widely in evidence. It arises directly from the role of the RDAs in handling the legacy of the SRB funds and from an established regional infrastructure for "bottom up" approaches under European social inclusion measures. In both of these long-standing grant regimes an early focus on basic capacity building for area based local groups had already given way to an increasing focus on the promotion of "enterprising localities or communities" before the new focus on social enterprise emerged in its current more prominent form. An area based, regeneration zone or local neighbourhood dimension of the approach to supporting social enterprise features as a strategic priority in virtually every region. The East Midlands has, for example, embedded this approach in its broad regional strategy for *Economic Inclusion* and has branded it for area-based application under the title *Local Alchemy.* In the West Midlands a pre-existing flagship for social inclusion policy has been through a comprehensive system of *Regeneration Zones.* This has provided an obvious platform from which to begin thinking about a social enterprise policy applicable to local areas. In the North East a similar emphasis on bringing support to local areas to assist in social enterprise development has been through a *Community Enterprise Network.*

What Will Give Best Returns and Who Can Help Put Social Enterprise in Place?

Part of the difficulty for the RDAs was to find cost efficient ways of integrating social enterprise into their portfolio in the face of what was described earlier – competing discourses and the high transaction costs of dealing with the sector representing a complex bundle of interests. What was immediately clear a year ago was that virtually all chose the obvious

route of supporting outside agencies within the sector to make things happen. Some had taken a more direct role in this – bringing together groups themselves and taking an active leadership role. Others had taken a more arms length approach – capacity building others and standing back and making use of their input. The box below shows the broad shape of emerging patterns at that time.

Box 3 RDA approaches to enabling partnerships

Consortia built for purpose with a strong RDA lead

Where an RDA has a clear view of what is needed to develop and sustain social enterprise, one model to emerge is a fit-for-purpose partnership or network. The objective here seems to be to do two things in combination. First, to assemble together organisations with the requisite *special knowledge and experience*. Second, to place them in a context where *regional knowledge* is added to the mix by putting them alongside players that can give voice and expertise derived from local interests. Emerging structures in the East Midlands (SEEM), London (London Social Economy Task Force) and the South West (RISE) are relevant here - though with individual variations on the theme. The East Midlands and London have much in common. Both have sponsored the engagement of national (but often also regionally configured) organisations – e.g. the Development Trusts Association (DTA), Community Action Network (CAN), Social Enterprise London (SEL), Local Investment Fund (LIF), Industrial Common Ownership Finance (ICOF), New Economics Foundation (NEF), and the Association of British Credit Unions Limited (ABCUL). The core aim is to engineer a locally informed regional support network for social enterprise. The national move to draw Business Links more closely to the social enterprise agenda has seen their profile rise across the board. Finally, the South West example of RISE is specifically dedicated to assembling a group of wider players to engineer a support platform for social enterprise

Network/Sounding Board Assembled from Regional Players

This model has usually emerged more directly out of regional social economy interests. While the RDAs have often had a sponsoring role – some leading, others tending to follow and respond – the driving force here seems to have been from "the sector". Building a regional support structure is still the key objective but perhaps with a weighting more towards the "sounding board" function than assembling the necessary expertise regardless of its provenance. This model also tends to be more reflective of "regional realities" with some Chief Executives indicating that they find the "politics" of it all off-putting where there are easier performance targets to be hit. Unsurprisingly, some RDAs are having more difficulty than others capturing the sort of coherence of sector view that they need. Where this has run up against resource constraints and pressures on staff things have tended to proceed more slowly. What can be described as the more "complex" regions with long histories of grant funding come under this model – e.g. Yorkshire and the Humber, the North East, West Midlands and the North West. For all of these regions there is also the tricky issue of *sub regional* differences. Histories of separate cities and their hinterlands and of differentially operating funding regimes (Merseyside and South Yorkshire as Objective One regions is an obvious instance) have added extra transaction costs for RDAs. Development agency roles here at regional level have sometimes seemed "one step removed" – leaving sub regions and partnerships to take the front line role while the agency itself sets out to support their actions and give a regional scale to those actions where it is needed.

A Club or Small Cluster of Organisations to give Policy Direction

Funding histories, geography and RDA resources also seem to be the discriminating features of this small grouping. For them there is less evidence of the intensive bid and challenge fund histories of the previous group and, as yet, the support structure strategy is in embryo. The two RDAs involved – EEDA and SEEDA – seem to have made use of a small group of knowledgeable players to help them. It is no co-incidence that they are also agencies with limited internal resources that are generally regarded as representing affluent regions with significant rural populations (though both have pockets of deprivation). In both cases it has seemed most rational to latch on to existing partnership groups. Both have, for example, comprehensive EQUAL partnerships in place for the current funding round providing ready-made vehicles to support their first steps toward wider partnership and engagement. Both also have some local social economy and voluntary sector bodies to which they can turn for advice and assistance. There is no necessary reason to suppose that the structures that eventually emerge will have to adopt the format of the other regions.

What came out from the study of these arrangements was that there was considerable variety in approach. In most cases, an individual RDA had to engage as a relative newcomer in those often arcane arrangements that had grown out of the complex regional history of the Third Sector. The European assisted regions, the inner cities, the SRB neighbourhoods and the urban industrial conurbations in general had been building up these organisational behaviours over 20 years within a whole micro-politics of grant aid. By contrast, the non-assisted regions and rural areas had seen a less intense experience of bid and challenge and the cultures it generates.

From region to region the RDA had to face very different circumstances. There was no such thing as a level playing field.

How Will We Know What Works?

The difficulty that the RDAs confronted in the case of social enterprise was: a) knowing what it was; b) knowing how to measure the impact of any actions they might take; and c) being able to see how such actions might be better targeted. The key problem was the lack of a rigorous evidence base. While the RDAs mostly maintained that they were "not hung up on definitions when it comes to strategy", this was not going to do, however, if they were to assemble an evidence base to measure the impact of their actions.

Virtually all of the agencies had either completed or had in progress a "mapping study" as the starting point for policy development. Significantly, however, while some of these studies had a tight focus on the narrower (trading based) definition of social enterprise, the bulk of them attempted to measure the shape and value of the social economy as a whole. A particular difficulty arose where the same label - social economy, social economy organisation or social enterprise - had a different operational definition and a different dataset to describe it. For some, there appeared even to be an assumption that measuring the one was adequate as a base for dealing with the others.

To quote the London Social Economy Task Force document, "without a great deal of rigour in standard definitions, methodologies and practices", it will be impossible to make effective use of target driven approaches to set benchmarks and monitor output. A good start was going to be for the sector itself to set some quality benchmarks for definitions, mapping and evidence collection.

A year ago it was too early in the process of adopting the social enterprise initiative for all but one of the RDAs to have put in place a formal monitoring and evaluation procedures. This simply confirmed that, as yet, the situation was too fluid for the basic parameters of a monitoring and evaluation system to have been set up.

The Conclusions of the 2003 Study

The 2003 study showed clearly that social enterprise was new but gaining ground in the RDAs. Commitment was already present but was still in the process of being garnered. There was, however, still a real challenge for the sector itself to exert a constructive influence on the way the agenda was going to evolve. There were some particularly critical matters for internal "housekeeping". Questions of clear and uncontested definitions, of being realistic about the weight of the wider social economy and of social enterprise within it, of which actions would give best returns on the sector's

own effort, of what sorts of wider alliances needed to sought, of how to tackle the tendency to over-hype success. All needed answers.

From the viewpoint of the RDAs there were also four primary requirements to be met if the social enterprise agenda was to be installed in the mainstream. They needed to:

- Achieve clarity of purpose and commitment for the social enterprise agenda;
- Articulate their strategic vision for social enterprise and commit to clear actions;
- Engineer regional partnerships to rationalise and clarify the multiple voices from the sector ;
- Assemble evidence bases and measurement systems to establish the real value added contribution of social enterprise;

From the viewpoint of the sponsoring department in government (DTI) the key requirements that were to be met in carrying them through the three year action plan were as follows:

- Create an enabling environment;
- Make social enterprises better businesses;
- Establish the value of social enterprise;

In the year that followed there were to be a number of changes that were likely to have a significant impact on how these were carried through and we now turn to see how the RDAs fared both internally and in the face of altered external circumstances.

3. Social Enterprise in the RDAs: A Year On-Rolling the Process Forward

We are now at the end of the first year of the DTI strategy for social enterprise and the brief for this paper is to look at again at the situation in the RDAs. What might have been expected was for the search to continue to get answers to the key questions set out earlier and to get the policy off the ground. The evidence shows that this was indeed the case in the period up to the end of 2003.

The DTI's Progress Report on Social Enterprise published in October 2003 notes the "active support of the regional agencies" in delivering the new policy initiative. It lists the RDA's actions as follows:

- Improving the evidence base
- Mapping the incidence and impact of social enterprise in the region
- Supporting the development of social accounting tools
- Structures and networking
- Facilitating joint working between regional partners
- Working with the public and statutory sectors – particularly in public procurement arrangements
- Developing integrated regional business support structures
- Holding conferences, events and trade fairs for the social enterprise sector
- Technical Assistance
- Offering targeted grants to build capacity, build assets and become financially more sustainable
- Helping create CDFIs and other loan and equity funds
- Supporting training
- Providing incubation space
- Providing web based services to promote training
- Building the support capacity of Business Link Operators to assist social enterprise

This represents an impressive array of activities driving forward the three priorities set out in the previous section. Indeed, were it to be a comprehensive menu being resourced, championed and delivered across the majority of the RDAs it would mark very substantial progress. With such additional information as it has been possible to glean from the region by region activities in the Progress Report and from other sources and informal contacts, it appears that the reality is rather more patchy.

The 2003 study reported earlier emphasised above all the extreme variability in the RDA response to the social enterprise agenda from region to region. It also indicated that there was a different level of "buy in" across the RDAs. The point was made that there were both competing discourses of social enterprise in play and a continuing debate about the

weight to be given to each of them. So soon after the research was undertaken it would be unreasonable to expect that things would have dramatically changed in the RDAs. A closer examination shows that the list of actions set out above maps very differently onto the regions. Some "score" on several items on the list and others on very few. The regions that the earlier study showed as the most advanced (London and East Midlands) continued to broaden and deepen their base of activity while, at the other extreme, some regions were either only just setting out to install support structures or were still constrained by resources and personnel to very small scale pilot actions. A list that might set out what seemed to be the commonly applied agenda for social enterprise across the RDAs at the end of 2003 might look shorter:

- Mapping exercises
- Awareness raising by events, fairs and masterclasses
- Networking through Forums, Consortia and dedicated Third Sector Organisations for social enterprise
- Small grant and bursary schemes for training, capacity building and technical support
- Feasibility studies and early launch of development, catalyst and other CDFI funds
- Toolkit developments of various kinds

Most of these actions could be considered small scale and relatively soft for the RDAs when set against their wider portfolios of land and property development and the promotion of regional clusters and centres of excellence. Progress there has undoubtedly been but, entirely understandably, the RDAs are moving forward slowly and cautiously on social enterprise – feeling their way against what is for most of them "just another initiative" among the many they are centrally mandated to support.

Consistent with this step-by-step approach, every RDA has appointed consultants to conduct a "mapping exercise" - finding out what social enterprise is and how much of a contribution it makes to the region was always an obvious rational starting point . This goes in parallel with the various methods of awareness-raising. As low cost - high reward events, masterclasses and so on can also support a strategy of exploring the shape and weight of the agenda. Also consistent is what might be called "constituency building" – bring on board the players of the voluntary and community sectors and seeking to engage them in the delivery of the strategy. Grants and bursaries, feasibility studies and developing toolkits fill out the package – small scale investments to support the process. Looking back to the first section of the paper and the identification of the broad shape of RDA activity from today's viewpoint there seems little reason to amend what was said.

The Impact of External Events

While there is little new to report on the pace and shape of changing events across the RDAs themselves this is not the case at national level. The Social Enterprise Unit was busy during its first year of operation promoting the social enterprise message across government and was achieving "wins" with most departments - not least the Treasury. The Progress Report is far more convincing on its record of national level actions than on those in the RDAs. There is a strong indication that here the unit was "swimming with the tide" of the Number 10 agenda for a radical review of public service delivery and a mixed economy of public service provision. The Voluntary and Community Sector (VCS) was being positioned as a key "third leg" of the new delivery regime (alongside the private and state sectors) and this chimed in harmoniously with the DTI push to develop social enterprise as trading oriented enterprise with social values. The arrival of Futurebuilders and the extended consultation by the Home Office Active Communities Unit on the role of the VCS signalled a change in the government view of the sector that drove it in the direction of social enterprise.

The Bank of England Review, Finance for Social Enterprise and Legal Reform

The Bank of England review was also a critical event in giving profile to the financial dimension of the social enterprise agenda. This gave additional impetus to moves to improve the investment readiness of social enterprises and to make sure that appropriate finance and funding was available to support it. Once again the questions; "what precisely is social enterprise" and "what is its value to the economy" were central to the enquiry. The Bank's proposals were set out under three headings:

- Developing a better understanding of the social enterprise market
- Formalising the process of arranging finance
- Increasing the supply of finance

The long-standing and widely recognised need to come up with new legal forms for social enterprise to overcome the straightjacket of current arrangements also saw some forward movement at the centre with proposals to revise company law to create Community Interest Companies (CICs). Once again the attachment of this to the new public service agenda is clear:

"CICs should develop to meet the needs of local communities complementing core government services such as childcare provision, social housing, leisure and community transport"

Only a shortage of parliamentary time saw this, along with the Charities Law Review, mark time for the current parliamentary session.

Returning to the RDAs as the subject for this paper, there is some sign that the new impetus being given to the financial aspects of support for social enterprise was getting through. There is a growth of interest and action in the sponsorship of CDFIs and catalyst and development funds with the East Midlands and London again leading the way.

Reorganisation and the Social Enterprise Unit

While on the one hand the RDAs were being invited to watch the growing importance of supporting social enterprise across virtually all the central departments and to take encouragement from this in developing their own strategies, a reorganisation of the DTI at the turn of the year produced an event that was capable of denting this growing confidence. In January 2004 it was decided that the Social Enterprise Unit would be transferred from the Regions Sub-Group to the Small Business Service Sub-Group of the DTI. Whatever the logic of the internal reorganisation itself, symbolically this could have been interpreted outside Whitehall as a significant downgrading of the importance of the new policy initiative. The departure for personal reasons of the popular head of the Unit Barbara Phillips added to the climate of concern. From the outside, it looked as if social enterprise had been shipped off as another business initiative to an SBS that up to that point (with the exception of the Social Inclusion Group administering the Phoenix Fund) had shown little interest in it. There was also a potential move from the capital to Sheffield.

Representations by the score were made to the Minister responsible from the sector and its representative bodies. These produced an assertion by both the Minister and the Chief Executive of SBS that there was to be “no downgrading or marginalising of social enterprise” and that “the SBS will provide a more supportive environment for the Unit because its staff will be working alongside colleagues with common objectives and with an additional knowledge of enterprise”. Taking these assertions at their word and accepting that no downgrading had been intended there is still, however, a hiatus while the new Director of the Social Enterprise Unit is appointed and the physical move takes place. At the very least it is to be expected that there will be a loss of momentum and that the querulous (perhaps in senior positions in the RDAs) will opt for a “wait and see” stance.

A more recent event has further muddied the waters surrounding the new “minders” of the Social Enterprise Unit. It has recently been announced that, following a pilot phase when three RDAs had taken contractual responsibility for their regional Business Link Operators, all the BLOs would now be transferred from the responsibility of the SBS to the RDAs. In truth the Business Links, though mandated to support social enterprise and to incorporate it into their operating plans, had with one or two exceptions found it hard to engage with social enterprise – seeing it as unlikely to make a substantial contribution to the Regional Gross Value Added that forms the central core of their target mission.

It is small wonder under these circumstances that the RDAs have taken what, from the outside, looks like a “softly, softly” approach. They are yet to achieve full clarity of purpose and commitment for the social enterprise agenda and go on to articulate the strategic vision for social enterprise and commit to clear actions. They have, it is true, done much to engineer regional partnerships and to rationalise and clarify the multiple voices from the sector. They are still very much in the process of assembling the evidence bases and measurement systems they need to establish what the real value added for social enterprise is.

4. Some Reflections on the definition and purpose of social enterprises

For the DTI, as we have seen, the definition of social enterprise is clear and as far as the RDAs are concerned it is to this definition that they must address themselves:

“A social enterprise is a business with primarily social objectives whose surpluses are principally reinvested for that purpose in the business or in the community rather than being driven by the need to maximise profit for shareholders and owners” (DTI, 2002, p13)

Welcome though this broad statement has been, a particular problem with social enterprise is that, as we have also shown, it does not offer the necessary level of operational clarity that is needed in a field that continues to be awash with labels. The problem still to be confronted is how to make a convincing case that social enterprise can add real social gain and economic value at an efficient cost – particularly in the face of opportunity costs in relation to other possible uses of scarce RDA time and resources. So how can the different elements of the social enterprise agenda be separated out from each other in ways that can help to distinguish the different kinds of outcomes that are possible?

Some European perspectives might help. Taking a wider view than that of the UK government, Laville (2000) defines social enterprises as follows. They are: “enterprises initiated by groups of citizens who seek to provide an expanded range of services and more openness to the community - they place a high value on independence and economic risk taking”. From Laville’s perspective social enterprises do more than simply trade goods and services. They offer a vehicle to empower and integrate people. By doing this they can use trust to reduce their transaction costs and can create the conditions needed to mobilise goodwill and free volunteer labour. Their primary goal is one of service to the community with an ambition to generate a wider social benefit. Looked at this way, many social enterprises can be described as quasi-public organisations in that they offer services that are, one way or another, paid for by public funds. They may, of course, do this by grant aid or through a service contract. Other social enterprises depend upon philanthropic giving. The normal condition is for combination of each of these but, for the social enterprise label, demonstrating some level of trading activity is a requirement (there is no DTI requirement here, however, for it to be greater than 50 percent of revenue).

Everything we know about these sorts of organisations – whatever label defines them - makes it difficult exclusively to apply narrow business logics. They may be encouraged to become more “businesslike” but to regard them too narrowly as business enterprises is often to misunderstand their ethos and function. What these sorts of organisations also do is to mobilise social

capital. This tends to crystallise around the collaborative provision of service to the community (of place, faith or interest) and is the basis for generating a social capital asset that is represented by more than just the value of traded goods or services.

These wider concepts of what social enterprise is underpin much of the confusion about what is currently being promoted by government in the UK and being recommended to the RDAs. Some well-established social enterprises are, of course, in a position to respond to the DTI emphasis on trading activity and are rightly basking in the limelight of the government's new enthusiasm. The danger is that there are not enough of them to justify the attention being given (contribution to regional GVA for example) and the success stories tend to occupy specific sectoral niches (in re-cycling, leisure and recreation and health and social care for example). Not all social enterprises can or should, from the Laville perspective, aspire to match one model (trading as >50% of revenue). There are many other models and types of players in this rapidly expanding sphere of activity. What is needed is a clearer view not only of the trading essence of social enterprise (which is fine in itself) but also its breadth and dynamics.

Social Enterprise as a Device for Mobilising Social and Civic Capital

Essentially this view focuses on the ability of social enterprises to mobilise social capital "through reciprocal relationships that integrate a dimension of service to the community". The primary goal is one of service to the community with an ambition to generate a maximum of collective externalities. These organisations are primary generators of merit goods and as such the value created cannot easily be captured within them (measured in their revenue streams). Their surpluses are redistributed to the charitable cause. They tend to colonise social and labour market integration, community development, public health and social care and many localised elements of the "regeneration" agenda. They are often quasi-public bodies except where they can depend upon philanthropic giving of one kind or another since they (rightly) depend on heavily on public support. They may, of course, engage in trading activity as one aspect of their portfolio but are not defined by it. To measure the added value of organisations for which this component of activity is substantial sophisticated measurement is needed (double bottom-line or social audit-social cost benefit).

A particular feature of Laville's model is that he sees these sorts of enterprises as being capable of sitting across and linking what he calls all three poles of the economy: - the market, the state and the non-money (or reciprocity) sectors. A wider perspective sees them as part of the Third System - a dimension of the economy that stands at this interface and that is a powerful engine for innovation and creativity and that incorporates a degree of social responsibility at its heart. The precise organisational form of these sorts of enterprises is less important than the shape of their

economic and social contribution. They may involve combinations of local action, state initiative, private philanthropy, and corporate social responsibility. They are a key part of what has been identified as "new dynamic of social enterprise" – one that is open and porous and capable of producing a myriad of hybrid forms.

What is perceived as the great threat to the evolution of these sorts of social enterprises is identified as a tendency toward isomorphism - driving towards a single enterprise form that replicates the orthodox small business and loses the essential difference between this and the true social enterprise. The concern is that this may come about not by design but as a collateral effect of the bandwagon effect of engagement with the narrower prescriptions of public policy.

Distinguishing the Delivery of Goods and Services from Civic Capital Creation

To move forward constructively in the policy domain there is a clear need to distinguish between what might be described as the "people and solidarity" structures discussed above and, quite separate "business and value driven" structures. Delivery demands focused, efficient and effective vehicles whereas the multiple goals needed to build social and civil capital often make for poor focus and the complexity of partnership transactions can work against efficiency. Dealing with these counterpoised properties of the social enterprise is not best handled by regarding one as always satisfactory and the other always not. The task is to explore the nature of the balance between them – finding out where focus and efficiency drives out social capital building and where the latter drives out the former. Finding the optimal position on both dimensions is surely the real measure of success.

There is no doubt that social enterprises can be effective and efficient instruments for the actual delivery of value for money goods and services. The purpose is simultaneously to see what can be done to promote social capital creation within an equation of entrepreneurship and business development. The most successful social enterprises are often those that have evolved themselves as multi-functional entities. They organise in such a way as to combine together a social capital role with a trading and enterprise function in way that captures benefit from both – having for example a trust board to deal with their legitimacy and governance and one or more trading arms to focus efficiently on service provision. It is precisely these complex but creative hybrid forms that Laville (2000) sees as the driving force for the new dynamic of social enterprise.

A Basic Segmentation for Social Enterprises

To find a pragmatic route through these complex (and often highly academic) issues there is a need to find some instrument that can help to segment the overall population of social enterprises into discrete and

internally coherent categories where the difference of mission is clear and where one form of anticipated outcome will not be confused with another. There is also a need for such an instrument to assist the enterprise itself to come to terms with the parallel dimensions of the mission. The purpose of such an instrument needs to be unashamedly a practical one. Support needs to be tailored to each segment differently and audit and evaluation needs to start from a prior identification of sub-populations with common characteristics. An early version of such a tool currently in the prototype and evaluation stage is BRIAN.

Tools for Social Enterprise: BRIAN methodology

The point has been made that social enterprise can be visualised as a complex segmented population of organisations and that one of the features standing in the way of developing practical policy is the need to deal with the issue of definition. While recourse to theory might have its place, there is also a key role for an empirical approach that can explore a “population of social enterprises in place” and learn something about the structures that can be discerned within it. The lens though which the population is observed does, however, need to be the right one allowing the mix of business and social purpose to be revealed. BRIAN (essentially a meaningless acronym) was devised for a population of social enterprises in Devon and Cornwall in order to facilitate the evaluation of A Phoenix Fund project conducted by Co-active Limited (a re-engineered CDA).
The Radar Plot and the Prime Axes

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.

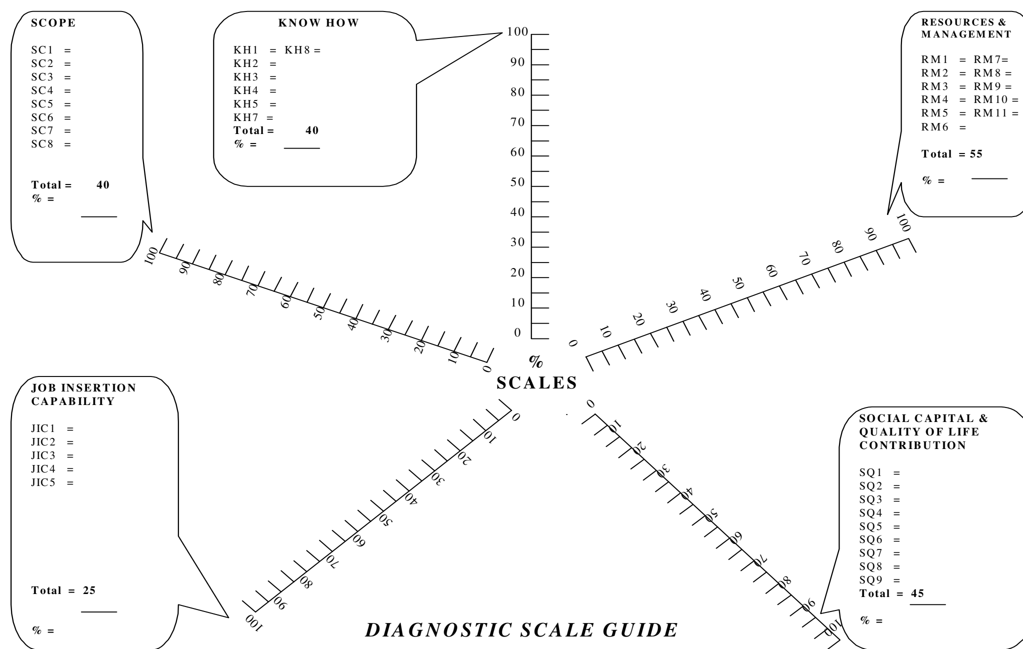
- Business logic (3 scales)
- Social purpose or solidarity logic (2 scales)

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 judgment.

The box 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 how this is applied to aspects of business performance;
- Resources & 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 4The Radar Plot and the Five Scales



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 of two main types; 41 enable the creation of the radar charts and a further 27 build up a typology of the population of social enterprises as a whole

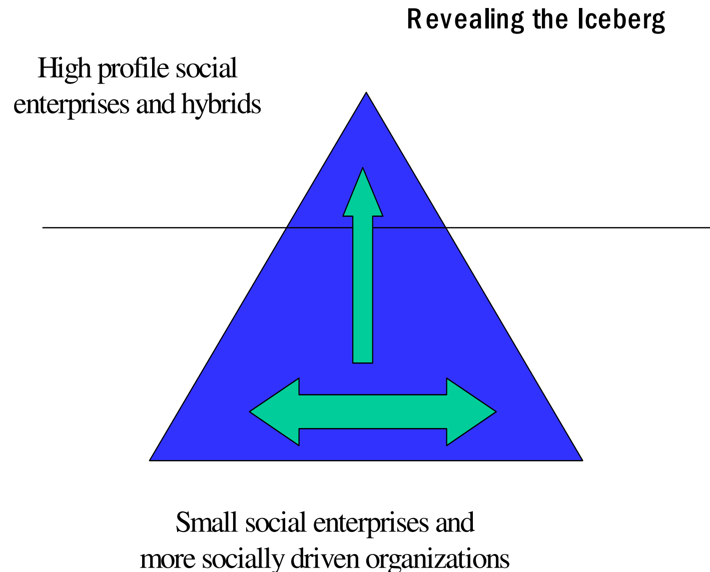
The elements in the "balloons" attached to each of the scales (JIC1, SC1 etc) represent a series of scores recorded from response opportunities (from questions) that lie at the heart of BRIAN. These load onto the relevant dimension and take the form of 5-point Likert scales with answers ranked from high (5) to low (1). The design of the questions involves a time-consuming and iterative process. First approximations to questions and rankings are run with respondents and through an iterative process of re-design and re-run a broad agreement emerges about what works best. The greater the number of trials the better the questions become .

Segmenting a Population of Social Enterprises

Revealing the Iceberg: A Highly Skewed Population

By running BRIAN over a large population of "potential" social enterprises it becomes possible to use the radar plot shapes and other parameters to identify key segments. To date this has only been done in a small number of localised settings but, while ex-post segmentation will have to wait for a larger sample, a number of features are already emerging that hint at a number of issues that policy will need to address. The most important is that the population is likely to be highly skewed - with very large numbers of very small organisations pursuing missions closer to the social capital and quasi-public service agendas set out earlier and a very small number of larger ones accounting for the bulk of the turnover and jobs in any given local and regional setting. Conceptually, Figure Two shows what a typical regional population of social enterprises might look like.

Box 5 Revealing the Iceberg



Culled out by the criterion of greater than 50 percent of turnover from traded goods, the population may well shrink to a handful of well-found "true" social enterprises. Even those labelled as "aspiring" social enterprises would be very small in number. If the wider application of BRIAN shows this to be the case generally then the fears of the RDAs and the Business Links that social enterprise is unlikely to make a meaningful contribution to Regional GVA will be well founded. It is not, of course, that the smallest and least businesslike enterprises are not making a contribution as was pointed out earlier. To value the contribution of the entire population, the need is to avoid accelerating the tendency to what was earlier called isomorphism and to devise a system of measurement of value added that operate outside the standard measures and ratios.

In terms of Figure Two something of the wider policy mission can perhaps be revealed. Clearly there is a need to "float the iceberg" – that is add to and expand the scale of the population of those "above the waterline". This is entirely consistent with DTI strategy and fits an action plan dedicated to creating an enabling environment and making them better businesses. If there is a means to identify those below the waterline that have the propensity to be "full social enterprises" (BRIAN) and that can be supported to get there, so much the better. But, what of those below the line? Growing such a population "horizontally" by making it better able to survive and fill niches where the market is unlikely to operate is surely also valuable – especially where this can be done at minimum cost and with a maximum of self motivation (BRIAN).

Getting a balanced perspective on the segmentation of social enterprise

At present the only widely used categorisation of social enterprise is that set out by Social Enterprise London with the following types:

- Employee-owned businesses
- Credit Unions
- Economic Development Trusts
- Co-ops: service, retail and housing
- ILM companies
- Community businesses
- Charities trading arms

This has its merit in showing one form of segmentation and the complexity of the population but it focuses on functional forms dominated by legal status. What BRIAN can add is a dimension that need not focus on legal form with all its pitfalls but on “shapes of mission” qualified by size, legal form or other primary attributes. The other feature of such a segmentation is that it leads directly on to both “signposting” and to tailored business support once a social enterprise has itself identified where it needs assistance. Given that cost effectiveness is likely to be a key criterion for RDAs and their constituent Business Links to extend their role in relation to social enterprise, having the organisation itself contribute to the determination of its needs is likely to be of value.

Conclusion

BRIAN is at a very early stage of its development. Its merit at the present time is, however, that it can serve as a conceptual tool to indicate where some of the difficulties for the current social enterprise agenda are to be found. What is revealed is that the push for a policy that is narrowly constrained to only those that can trade over 50 percent of their turnover has to be regarded as no more than a partial approach. There are good reasons for doing it this way, of course, and as an acknowledged partial approach there is nothing wrong with it. From region to region it may be that, say, 10 percent of all potential social enterprises are “full social enterprises”. It is right that these should be supported, that appropriate financial instruments should be designed to meet their needs and that they should be given the opportunity to engage fairly in bidding for public service contracts. If 10 percent can rise to 20 percent then so good.

But what of the 80-90 percent that fall below the line making a small “business” but a significant “social capital” contribution? What is wrong with recognising their contribution and attempting to make them more businesslike? The majority will still need some form of public grant aid but this can be in exchange for a measurable social welfare contribution. There is a danger of “babies and bathwater” unless the wide spectrum is recognised and its different segments are treated differently and values for their different contribution.

5. Finance in the United States

Finance for the social economy in Northern Ireland is an economic imperative for the country's long-term prosperity, equity, and political stability. Successful, large-scale inner city revitalization in today's global economy can only be of significant size and impact if the private sector finds it in its economic interest to invest substantial private resources to rebuild troubled neighborhoods. This requires public policy to develop market strategies that encourage the private, not-for-profit and public sectors to collaborate in ways that encourage the private sector to invest large-scale private capital assets wholesale in order to produce a significant "double bottom line" return:

- Risk-adjusted market rates of return for private investors, and
- Measurable job and wealth creation and community revitalization for community stakeholders.

The design and development of the Ulster Community Investment Trust of Northern Ireland (UCIT) drew upon the first generation of this North American practice. While UCIT was being built, a whole new approach in the United States was emerging—a "second generation" of market-rate Community Equity Funds that attract world-class fund managers and investors because of recognized opportunities to capitalize on market imperfections in inner city markets. These market imperfections can produce risk-adjusted market rates of return for investors while at the same time producing significant job and wealth creation for community stakeholders.

This paper traces the evolution of this market from a first generation of smaller, below-market, grant and debt funds to an emerging second generation of larger, market-rate, equity-based inner-city investment funds. Many of these second generation funds show promising returns and community impact, but their combined capital—US$ 2.5 billion in the last decade—is still well below the full scale of both need and opportunity in North American inner city markets. This paper summarizes the evolution of best practice in North America since the design and implementation of UCIT, and outlines the current steps to move this market to a broader and larger investor base that can take North American practice to full market scale. Accessing larger pools of capital in the next few years requires market sensitive innovations that are consistent with the behavior of capital markets and do not distort them.

The following pages will provide a short overview of the developments and key issues in the social enterprise finance models in North America since the mid 1990s. It will also address the enabling and constraining factors and begin to suggest how the experience might be transferred to a different market, legislative and fiscal context.

The First Generation—Supplementing the Market with Below-market Capital

Historically, predominantly below-market community investing has sought to supplement the market, making socially and environmentally important investments at a below-market cost of capital to investment recipients and a below-market return on investment for investors. The great majority of these earlier North American organizations and funds were structured as not-for-profit corporations.

Because of its below-market character, this first generation of community investing was only able to access smaller amounts of private capital, so the proponents of community investing pursued government assistance. As its major community investing initiative, in 1993 the Clinton administration sponsored the Community Development Finance Institution (CDFI) Fund housed in the U.S. Treasury. As of September 2003, this Fund has certified 660 CDFIs and invested US$ 534 million in CDFIs. According to the National Community Capital Association, the leading trade association for CDFIs in the United States, there are today more than 800 CDFIs in the U.S. lending and investing more than US$ 8.2 billion in low income neighborhoods. These CDFIs include 200 community loan funds, 250 community development credit unions, 40 community banks and numerous micro-credit organizations, as well as community development venture capital (CDVC) funds.

UCIT was conceived based on the best practices of the first generation funds, but came into existence as the second generation funds were coming on line. The balance of this report describes the emerging second generation best practice.

The Second Generation—Guiding the Market with Regional Market-rate Initiatives and Funds

While sharing a goal of financial and social returns, double bottom line regional initiatives and funds differ from CDFIs in significant ways. Regional double bottom line initiatives and funds take a more comprehensive approach to revitalization of inner city neighborhoods by investing in industrial, commercial, and mixed-use real estate, affordable and mixed-income housing *and* growing businesses, and doing it within a *family or cluster* of interrelated for-profit funds that operate within a policy framework and under accountable oversight to a not-for-profit umbrella organization that brings business and community stakeholders into an ongoing partnership. Finally, and perhaps most importantly, the not-for-profit participates in income streams from the for-profit funds for value received in ensuring that the “second bottom line” goals are met.

These emerging regional investment initiatives are based on the recognition that a new development paradigm is needed. Whether this new paradigm is characterized as sustainable regional development, smart growth, or double bottom line investment, it is based on the recognition that successful urban real estate and business development must involve all the relevant stakeholders (business, community, government) to produce desired outcomes of economic prosperity, social equity and environmental quality (the 'three Es of sustainable development and smart growth).

Regional investment initiatives build links between business, community, environmental, and public leadership that establish long-term, mutually beneficial partnerships. Such partnerships can reduce conflict, increase certainty, and expedite the desired types of business and real estate development that are in the interests of all the stakeholders.

Regional funds make investments in the context of agreed upon regional goals and plans for growth and development that stakeholders have signed on to. As such, these funds are firmly embedded in the leadership infrastructure of the region. While informed by and often incorporating CDFI models, regional fund initiatives contain the promise of a more *systemic* approach to urban revitalization as they address multiple aspects of development and seek to alter the way economic development proceeds at a regional scale.

Second-generation "double bottom line" market-rate community equity funds are designed to attract large-scale capital managed by proven fund managers with outstanding track records. Community sponsors structure the funds to provide investors with market returns and community stakeholders with community revitalization and measurable job and wealth creation.

To date, the operating experience of these funds is divided roughly 60/40% between real estate equity funds focused on mixed-income and mixed-use housing, commercial, and industrial development that rebuild inner city neighborhoods (60%), and business equity funds focused on the rapid expansion of business enterprises that can make a measurable impact of job and wealth creation in these same neighborhoods (40%).

These new regional funds need to be large enough to create a deal flow to attract a proven, high-quality fund manager that, in turn, can attract large regional and national investors. The not-for-profit community sponsors and the key lead investors then structure the funds to:

- ✓ embed the goals of the funds in the operating agreements,
- ✓ protect the final investment decisions of the fund manager behind a firewall, and
- ✓ structure the fund to support the not-for-profit sponsor with an income stream to produce measurable job and wealth creation that is *then* post-audited for value received.

The income stream to the not-for-profit, special-limited-partner community sponsor must be earned *only* for proven value received by investors, fund

managers and community stakeholders—it is not a grant or birthright. In summary, the new paradigm of North American market-rate “double bottom line” initiatives and funds has the following common characteristics:

1. A comprehensive, regional, large-scale approach to revitalization of inner city neighborhoods;
2. Powerful shared goals by a partnership of private sector CEOs and community stakeholders;
3. Sponsorship and oversight by a regional not-for-profit private/civic partnership of these stakeholders;
4. A family of interrelated for-profit funds of sufficient scale that are managed by proven fund managers who attract large institutional investors;
5. The umbrella not-for-profit selects fund managers with investors, helps achieve the second bottom line, and monitors and publicly reports performance;
6. For value received in performing these functions, the not-for-profit participates in the income stream of management fees and profits (“carried interest”) from the funds.

To date, these Triple Bottom Line equity funds now have more than $2.5 billion under management, including more than $500 million in regional funds that are the heart of the emerging national system. Major bank investors include Bank of America, Citigroup, and JP Morgan; major insurance companies include AXA, Prudential and Met Life; major foundations include Ford, Rockefeller and MacArthur; major pension fund investors include the largest in the world, California and New York. A more complete list of types of investors is found in Appendix B below.

Although the second generation experience is not quite a decade old, early financial returns of second-generation regional funds to private equity investors indicate that risk-adjusted market rates of return are achievable. The first fund, the US$ 85 million Genesis LA Investment Fund substantially exceeded the expected mid to high teens annual IRR returns. The US$ 100 million Massachusetts Life Initiative has already successfully invested and returned its first US$ 100 million, and is now investing in its second US$ 100 million. Others are on their way to successful return on investment, and all are meeting their double bottom line expectations. In sum, financial returns to private equity investors have equaled or exceeded risk-adjusted market rates of return of "plain vanilla" funds of the same vintage.

Following is a description of the “alpha paradigm” second generation regional initiative/family of funds built in the San Francisco, California Bay Area:

- ✓ **The Bay Area Family of Funds**

- **The $160 million Bay Area Family of Funds** is an initiative, a family of funds, and three individual funds.
- **The Bay Area Family of Funds** is sponsored by the Bay Area Council (the CEO-led regional public policy organization) and community stakeholders, to leverage $1 billion targeted to the 52 neighborhoods in the Bay Area with high levels of poverty. These paradigm funds create powerful private sector and community stakeholder leadership in a self-sufficient not-for-profit sponsor to ensure that the three market-rate private equity funds with world class fund managers achieve *both* their internal market-rate of return for investors *and* the social equity and environmental returns expected of community stakeholders.
- **The $66 million Bay Area Smart Growth Fund**, managed by Pacific Coast Capital Partners (PCCP), invests in mixed-income housing and in mixed-use commercial and industrial real estate development to recreate vital inner city neighborhoods. The Fund, which had its final closing on 12/31/02, is now more than 50% invested in an array of community revitalization projects. The Fund is on track to produce the market returns (net 15-18%) expected by investors, and the job, wealth and environmental returns expected by community sponsors.
- **The $50 million Bay Area Equity Fund**, managed by JP Morgan H&Q, invests in technology, health, specialty food and life style companies at the moment of inflection when firms go from early stage to take off. An alpha paradigm "triple-bottom line" system for measuring returns assists invested firms with local hiring, neighborhood wealth creation, environmental and workplace benefits. The Fund has had its first close, expects its final close to be about $65-70 million and is now investing in its first deals.
- **The $40 million California Environmental Redevelopment Fund (CERF)**, invests in brownfield cleanup and expects to achieve appropriate returns in the high single or low double digits.

Building a National System of Second-generation Funds

Although the experience of these second-generation funds is still young, the elements of a self-reinforcing national system are beginning to emerge. The core of the emerging national system are regional funds that wholesale capital for direct investment in targeted low-income neighborhoods to accomplish specific job and wealth creation goals that are commonly shared by private, civic and community leadership at the regional level. This shared civic commitment distinguishes these regional families of funds from other elements of the developing national system.

These regional families of funds have innovated a broad range of funds to address multiple tasks—market rate, affordable and "workforce" mixed-income housing; commercial and industrial mixed-use real estate development; and job and wealth creating business investment. Having successfully built these market-rate inner city real estate and business finance funds, these regional families of funds are now designing specialized funds to provide land and site assembly, environmental cleanup, and wholesale gap financing to package real estate deals faster and more efficiently. Refer to Appendix C for examples of these regional funds.

Independent of the development of these relatively large-scale market-rate regional funds, a number of national market-rate private equity funds have also been created, and are making a significant economic impact with proven fund managers, successful track records and substantial private investment capital. These national funds could co-venture with the regional funds and do provide an alternate, competitive source of capital for large local deals. Sharing a common investor base with the regional funds, they focus either on large-scale inner city real estate or on the rapid growth of business enterprises that can significantly impact inner city job and wealth generation. The total capital committed to these national funds now approaches $2 billion.

Wholesaling Gap-financing Funds to Partner with Real Estate Equity Funds

It is essential to wholesale market equity through the regional and national market mechanisms described above. It is equally important to wholesale gap-financing funds to partner with real estate equity funds, so that fund managers and fund sponsors are not "nickeled and dimed" piecing together gap financing to close otherwise sound inner city real estate deals. These gap-financing funds are designed to reduce time and transaction costs, which increases the efficiency of deal making and expands substantially the capacity of the regional families of funds.

This is a key issue for Northern Ireland, where the majority of deals are subsidized. The challenge is to facilitate partnerships between gap-financing mechanisms and private sector funds.

The partnership between the second-generation regional fund and the provider of gap financing determines in advance the underwriting conditions that will govern investment decisions, as opposed to the current time-consuming and expensive practice of treating each deal as unique. The resulting reduced information and transaction costs, together with the relative ease of replicating these templates across the country, will accelerate the development of this second-generation national system. Refer to Appendix D below for a list of examples of these gap financing funds.

Creating Transparency for IRR Performance

Each of the elements of a national system of second-generation market-rate community equity funds exists. This national system can grow to scale if only its evolution is understood and encouraged in ways that are consistent with the behavior of private capital markets, and do not distort them. The market for second-generation funds cannot grow rapidly without uniform, transparent reporting by first- and second-generation funds of returns to investors and community stakeholders in a standard and timely way. Easy access to information of attractive returns to investors and communities will draw the attention of large institutional investors.

Public pension funds and foundations, the keepers of the investor conscience, are the logical institutional investors to establish joint standard reporting mechanisms for both IRR and measurable job and wealth creation, in order to take market-rate community equity funds to a vastly larger scale. Calpers, Calstrs and New York Common Public Pension Funds, three of the largest funds in the world, have all taken the lead on both targeted inner city investment and transparency issues. CalPERS has already challenged the venture capital industry and changed the industry standard by publishing returns of its portfolio venture capital funds on its website, including those funds that make up the $500 million California Initiative. If this base could be expanded to include other top public pension funds, we could change institutional investor behavior.

Creating Transparency for Job and Wealth Creation

The central challenge for double bottom line market-rate community equity funds is to encourage new economic activity in communities with high levels of poverty in ways that generate livable-wage jobs and create wealth for current residents while avoiding displacement. To accomplish the second bottom line—community equity—these market-rate community equity funds need to work with institutional investors--starting with leading public pension funds and foundations--to establish and implement straightforward, measurable economic, social and environmental criteria to ensure that current community residents tangibly and meaningfully benefit from the investment of these market-rate community equity funds. The post-audited results of these uniform standards then need to be published widely and transparently to institutional investors and community stakeholders.

Again, this work has already begun. The Ford and MacArthur Foundations have worked with the Bay Area Family of Funds to develop a post-audit reporting and evaluation system to establish job and wealth creation criteria and to measure the results. The Rockefeller and Heron Foundations have undertaken a similar effort with pioneer funds who are members of CDVCA. These efforts need to be combined in a common system and uniformly applied to all market-rate community equity funds throughout the country. If the results of both IRR and second bottom line reporting could be made

widely available to members of the Foundation Finance Officers Group (FFOG), we could advance much further the encouragement of foundation finance officers to invest directly from their corpus into market-rate community equity funds, and not just program-related investments (PRIs). Heron, Knight and the California Community Foundation are already doing this; now we must get other large foundations to join in.

Appendix A: Bay Area Smart Growth Fund Projects

The $ 66 million Bay Area Smart Growth Fund has made six investments to date, totaling $34.2 million, and is more than 50% invested. All investments are in one of the 52 high-priority targeted low-income neighborhoods of the Bay Area, have been developed in collaboration with community stakeholders, and are projected to produce market rates of return (mid-teens IRR) and measurable economic, social and environmental benefits.

1. The Story and King Road Project, in the heart of Southeast San Jose ($10 million investment in a $100 million project), is a community shopping center to be developed on 26.2 acres at a major intersection in an important Hispanic community. The project will replace an existing center with a mix of current tenants, new stores and restaurants and involve approximately 260,000 square feet of new construction. There has been broad consensus for many years that the commercial properties at the intersection of Story and King Roads need to be redeveloped and revitalized. The project will include a 50,000 square foot "Mercado," a multi-tenanted building with a variety of small merchants serving the Hispanic community.

The Story and King Road Project meets the Bay Area Smart Growth Fund economic, social and environmental criteria in the following ways:

- Serves as the gateway to East San Jose and is key in the revitalization of the whole area.
- Locates a supermarket (as well as other retail stores) to serve the area.
- Provides 100 local retail merchants with long-term leases in the Mercado, and with affordable rents and business assistance.
- Creates opportunities for local, minority, and women sub-contractors.
- Provides construction jobs as well as permanent jobs for local residents in the retail outlets.
- Employs green design and construction techniques.

2. The North Richmond Land Project, in North Richmond ($2.7 million of an $8 million total investment), involves the acquisition of three non-contiguous parcels of land (48.36 total acres) in the unincorporated area of North Richmond, California, one of the highest priority African-American areas for the Bay Area Family of Funds.

The developer and the Bay Area Smart Growth Fund will sell the first of three parcels for residential housing upon completion of environmental remediation and the receipt of the full entitlements. Ongoing rental income from the existing industrial tenant will cover carrying and operating expenses on the other two parcels. The exit strategy for the remaining land

is either to develop the property with for-sale or for-lease industrial buildings or to sell it as subdivided land parcels, or to market as a leased investment.

The North Richmond Land Project meets the Bay Area Smart Growth Fund criteria in the following ways:

- Provides environmental remediation for a brownfield
- Creates 140 units of mixed-income housing—112 affordable at 80-120% of median income (AMI) and 28 units deed restricted to be affordable to residents at 80% AMI.
- Builds the type of development envisioned by the North Richmond Land Use Plan and supported by the Contra Costa County Redevelopment Agency.
- Offers the opportunity for additional development on the remaining parcels with potential additional community benefits.
- Provides an opportunity to engage the Community Capital Investment Initiative in North Richmond, a major low-income priority neighborhood in the Bay Area.

3. Vallejo Plaza, in Vallejo ($5.2 million investment in a $16. 5 million project), is a 267,500 square foot community shopping center on approximately 29 acres in a neighborhood with a high concentration of Filipino and other Asian Americans.

Three anchor tenant spaces of the Vallejo Plaza, representing over 100,000 square feet, are dark. The shopping center has been in difficulty. One of these three anchor tenant spaces contained the only grocery store serving the area. The Bay Area Smart Growth Fund investment is financing the repositioning and re-tenanting of Vallejo Plaza – the location of a new grocery store specifically serving a Filipino and Asian clientele, a Mercado for local merchants, leasing other spaces including a Filipino banquet facility, upgrading the appearance of the plaza, and construction of seven acres of housing that will provide 200 affordable units.

Vallejo Plaza meets the Bay Area Smart Growth Fund criteria in the following ways:

- Brings needed retail services, particularly grocery services, to an underserved area.
- Locates ethnic retail services, owned by the ethnic group served, to Filipino American and Asian American residents in the area.
- Assists existing local merchants in increasing their income and new local merchants in locating in Vallejo Plaza.
- Increases affordable housing in the area.
- Supports the Vallejo arts community by providing space for non-profit arts organizations.
- Constitutes a mixed-use, mixed income, infill development.

4. The Gateway Retail Center, in Marin City ($7.1 million of a $25 million total investment), is a community-based shopping center in targeted low-income African-American neighborhood with 182,054 square feet of retail space. The Bay Area Smart Growth Fund is assisting the not-for-profit Marin City Community Land Corporation (MCCLC) to preserve its ownership of the property. MCCLC exercised its right of first refusal to buy out the for-profit developer, and the Bay Area Smart Growth Fund formed a joint venture with MCCLC to purchase the property and provided the financing for the purchase.

The Gateway Retail Center meets the Bay Area Smart Growth Fund criteria in the following ways:

- Though this redevelopment has a profound economic development impact on a targeted neighborhood.
- Restores/maintains ownership of the property by not-for-profit Marin City Community Land Corporation (MCCLC) with net revenues as a source of funding for community benefits in Marin City.
- Constitutes a fifty-fifty partnership with a community not-for-profit.
- The Gateway Retail Center will be properly managed, increasing the revenues to MCCLC, which will in turn be used for community benefits.
- Facilitates MCCLC's training necessary to manage the Gateway Retail Center for maximum community benefit.
- Refinancing is projected for 2008, with MCCLC becoming 100% owner and the Bay Area Smart Growth Fund exiting with its full financial return objectives.

5. Ascend Residential Properties, Inc, in the East Bay ($3 million investment, generating $45 million in affordable housing), specializes in acquiring, rehabilitating, and selling affordable homes in neglected target areas of Alameda and Contra Costa counties. Deteriorating buildings in these neighborhoods are becoming attractive homes in communities where there is a critical need for housing and revitalization.
Since 1999, Ascend has rehabilitated and sold over 100 homes and developed a solid reputation for producing a quality product. Virtually all of Ascend's homes have been affordable to moderate-income households, and 75% have been affordable to low-income households, where housing demand is the strongest. In November 2002, the Bay Area Smart Growth Fund re-capitalized the current management in a new entity, providing $3 million in equity capital for four years to acquire and rehabilitate approximately 200 single-family homes affordable to low and moderate income residents.

6. The Hegenberger Airport Business Park, in Oakland ($6.2 million investment in a $25 million project), involves construction of a research and development/flex industrial facility on 14.2 acres near the Oakland Airport. The site plan for the property contemplates construction of four industrial buildings for a total of 197,000 rentable square feet. The United

Brotherhood of Carpenters (UBC) has agreed to occupy one 72,000 square foot build-to-suit building, which is under construction.

The Hegenberger Airport Business Park meets the Bay Area Smart Growth Fund criteria in the following ways:

- Location in one of the targeted census tracts.
- Produces construction jobs for local residents.
- Provides apprenticeship/job training facilities, improving access for local residents.
- Transit oriented location near the new BART/Oakland Airport connector.
- Uses green design, construction, and operation mechanisms.
- Locate in the Coliseum Redevelopment Area, has extensive community involvement.
- Meets many Coliseum Redevelopment Area community goals.

Appendix B: Key Investors

Bank investors include Bank of America, Citibank, Fleet, JPMorgan, USBank, Union, Washington Mutual, Wells Fargo and many local community banks. The Community Reinvestment Act (CRA) brought them to the table, but market returns keep them there.

Insurance investors include AXA, California State Automobile Association, John Hancock, Mass Mutual, Mercury, Met Life, Liberty Mutual, Pacific Life, PMI, New York Life, Northwestern Mutual, Allstate and State Farm Insurance.

Foundation investors include California Community, Annie E. Casey, Ford, Jacobs, F.B. Heron, MacArthur, Knight and McCune Foundations, as well as local community foundations. The Ford Foundation investments to date are Program Related Investments (PRI); however, an increasing number—including California Community, Heron and Knight Foundations—are choosing to invest corpus directly because the funds are producing risk-adjusted market rates of return.

Public pension fund investment is led by the California Public Employee Retirement System (CalPERS), the California State Teachers Retirement System (CalSTRS) and the New York Common Public Pension Funds, with a number of other state, county and municipal funds currently weighing investments. Under the leadership of California Treasurer Phil Angelides, CalPERS alone has committed $500 million in market-rate funds targeted to inner city emerging markets.

Large not-for-profit corporations can also be investors, as Nehemiah Corporation has demonstrated. Nehemiah is the sponsor of the Nehemiah Sacramento Valley Fund and the Maryland Family of Funds, as well as a $5 million investor in the Genesis LA Real Estate Fund and a $3 million investor in the Nehemiah Sacramento Valley Fund.

Faith-based investors are an important—and largely untapped—asset class. Catholic Healthcare West has invested in the Bay Area Family of Funds, and Nehemiah is both a not-for-profit and a faith-based fund sponsor and investor.

Union pension funds are another important asset class. The Carpenters Union is considering an investment in the St. Louis Revitalization Fund.

Wealthy individuals are a logical next source of investment capital in second-generation funds. The first market-rate community equity fund to engage wealthy individuals as investors is the Bay Area Family of Funds. A number of individuals have committed from $50,000 to $150,000 in the first closing of the Bay Area Equity Fund. One national broker-dealer is considering offering these funds to wealthy clients.

Appendix C: Regional Smart Growth Fund Projects

Three Massachusetts private equity funds to accomplish specific public purposes have been capitalized by the Massachusetts insurance industry since 1977:

The 26-year-old Massachusetts Capital Resource Company (MCRC) has now invested almost $500 million in 275 mature shoe, leather, paper, fish-processing and technology companies in the $10-40 million sales range—creating over 15,000 jobs in the state since its initial capitalization in 1977. Two thirds of the investment has been in disadvantaged areas. Originally scheduled to end after a five-year tax credit if the insurance industry was not satisfied with the returns, MCRC has rolled over its capital five times and has consistently produced a net 18-20+% IRR, with the result that investors are committed to the partnership to 2023.

The $100 million Massachusetts Life Initiative, created in 1998, has invested more than $100 million in community-based developments in low-income areas in the past five years, and is now rolling over its capital to begin a second investment cycle. Investments are divided roughly 50-50 between inner city real estate and business enterprise. As an example of how first-generation, below-market funds and second-generation, market-rate funds can collaborate, the Mass Life Initiative is an $8 million investor in the Boston Community Loan Fund.

The $80 million Massachusetts Property and Casualty Initiative, LLC has been in operation for three years and has successfully issued commitments totaling more than $50 million to housing developers, businesses, not-for-profit organizations and community loan/venture funds.

These community equity funds join 28 other specialized for-profit, not-for-profit and quasi-public equity and debt (both private and publicly traded) financial intermediaries which, for the past 20 years, have collaborated to invest $10 billion in low-income community development in the state.

Three Genesis LA funds are sponsored by the not-for-profit Genesis LA Economic Growth Corporation to champion community development in Los Angeles County:

- The $85 million Genesis LA Real Estate Investment Fund managed by Shamrock Capital Advisors is 80% invested in commercial and industrial development, has provided investor returns exceeding the promised mid to high teens. As a result, a second fund is now being launched in which the community sponsor, fund manager and investors are committed to a more significant second bottom line impact.

- The $100 million Genesis Workforce Housing Fund, managed by Phoenix Realty, will invest in workforce housing targeted to 80-120% of average median income (AMI), a housing gap for crucial workers in most inner cities.
- The $20 million Fulcrum Capital Fund is investing in growing minority and women-owned enterprise that impact underserved communities in the County.
- The Bay Area Family of Funds, created by the Bay Area Council (the regional CEO-led public policy organization) and community stakeholders, are investing $160 million in equity to leverage $ 1 billion targeted to the 52 neighborhoods in the Bay Area with high levels of poverty. Refer to the Second Generation description in above text.
- The $29 million Nehemiah Sacramento Valley Fund, a community equity Smart Growth real estate equity fund investing in mixed-use, mixed-income developments in low income neighborhoods in the six-county Sacramento Valley, is sponsored by Nehemiah Corporation and managed by Pacific Coast Capital Partners. The Fund is a part of a complex set of community development tools developed and managed by not-for-profit Nehemiah Corporation—including the nation's largest down payment assistance program, low-income tax credit housing developments, and a community land trust. Nehemiah is, as noted, an investor, and now a sponsor of other funds across the country.
- The $60 million San Diego Smart Growth Fund, managed by Phoenix Realty, is the first of a series of funds sponsored by the San Diego Capital Collaborative
- The Portland (Oregon) Family of Funds, a private sector initiative linked to the Portland Development Commission, is soon to launch the first two of a large array of market and gap financing funds to continue the rebuilding of Portland—a Portland Communities Fund in partnership with FNMA and the Portland Historic Rehabilitation Fund, both of which wholesale critical below-market capital to partner with second-generation market-rate funds in the Portland Family of Funds
- The $55 million St. Louis Revitalization Real Estate Fund is sponsored by the St. Louis Regional Chamber and Growth Association and managed by Advantage Capital, a $550 million fund manager with a $110 million federal new markets tax credit allocation
- The Urban Initiatives Fund, managed by American Ventures Realty Investors, is a unique hybrid national investment vehicle with a series of regional initiatives—a pattern that may well become more common in the near future. The Fund provides mezzanine capital to targeted community development real estate projects, with an expected net 10 – 14% return to investors. The first two initiatives in the national series, with others soon to come, are:

    - $30 million in New Mexico, with the McCune Foundation as lead investor, and

- $75 million in South Florida, with the Knight Foundation as the lead investor.

American Ventures, Phoenix Realty and Pacific Coast Capital Partners are large fund managers engaged in managing multiple regional funds in multiple locations. These and other fund managers of regional initiatives may now begin to expand these efforts into larger regional and national funds. Other regional funds are now being designed and built in Boston, Massachusetts; Baltimore, Maryland; and Shreveport, Louisiana, to name a few. As is true of all the regional initiatives to date, each will have both common and unique characteristics, and each will add to the already rich body of growing national experience.

Appendix D: Gap Financing Funds

The Portland, Oregon Family of Funds is creating a series of below-market gap-financing funds to partner with its second-generation market-rate funds. Two are about to close: the $50 million Portland Communities Fund to wholesale affordable housing development in partnership with the FNMA American Communities Fund, and the $50 million Portland Historic Rehabilitation Fund to wholesale historic tax credits for development in partnership with a major commercial bank packager of secondary tax credit paper.

- Nehemiah Corporation is engaged in a wholesale fund discussion with the Federal Home Loan Bank Board.
- The San Diego Capital Collaborative was engaged in discussions with Freddie Mac until the recent change in senior management interrupted the initiative.
- The San Diego Capital Collaborative expects that the new San Diego Smart Growth Fund will establish a predetermined underwritng arrangement with the City of San Diego for the new $55 million pooled affordable-housing tax-increment bond-financing faciltiy.
- The San Diego Capital Collaborative also plans to establish a not-for-profit tax-exempt bond pool in which the underwriting criteria are pre-negotiated with potential commercial bank holders of the tax-exempt paper to lower the cost and speed up the process of having this gap-financing facility readily available.
- The Bay Area Family of Funds played a key role in building the state-wide California Environmental Redevelopment Fund (CERF) for inner city brownfield cleanup.
- The St. Louis, Baltimore and Shreveport funds expect to address their slower growing markets with federal new markets tax credits, and St. Louis and Shreveport may employ the state tax credits of CAPCOs.

Each of these pioneering gap-financing funds can become a template for similar funds around the country, which will, in turn, increase the capacity of the national system.