Introduction to Social Investment

Voluntary Impact Northamptonshire
Executive Membership

What is it?

Social investment is the use of repayable finance to help an organisation achieve a social purpose.
Charities and social enterprises can use repayable finance to help them increase their impact on society, for example by growing their business, providing working capital for contract delivery, or buying assets.

Social investment is repayable, often with interest. Charities and social enterprises may generate a surplus through trading activities, contracts for delivering public services, grants and donations, or a combination of some or all of these. This surplus is then used to repay investors.
Social investment is not suitable for everyone, and it should be considered alongside other options. It's important to look at the range of finance options available to your charity or social enterprise before deciding.

Social investment is not a grant or a donation. You must always know how you will pay back any investments.

What might you want it for?

There are a number of reasons why your charity or social enterprise might need social investment.

<u>Kick start your organisation or enterprise.</u>

Most start-up social enterprises are relatively high-risk investments because new businesses do not have a track record of success. Even if you have some evidence that someone wants to buy the products and services you're going to sell, there is no way of being sure they'll buy from you (or that you'll make a profit) until you start.

For most social start-ups, unlike their private sector equivalents, it is unlikely that your organisation will be able to offer investors a large financial return, even if successful. This means you will need to find investors who are able to accept that there is a larger chance they will not get their money back and a more limited chance they will make a substantial return.

Fortunately, social investors want their money to be used to create social value and those who invest in start-ups are often prepared to accept the 'high-risk, low return' reality.

Possible uses for investment

- Product or service design and development
- Delivering products and services to customers
- Sales and marketing
- Investment in systems (eg IT, online, data)
- Staffing costs

Maintaining cash flow

For example, you've been running for a few years, generating positive social impact and revenue, but need a cash injection to deliver a service, finance a contract or cover costs.

Possible uses for investment

This would normally be cash flow: your organisation is profitable overall and your income covers costs, but it doesn't always come in before the bills need to be paid. There are investment products that are designed to help organisations manage these gaps and dips between people paying you and you having to pay bills and other organisations. These are:

1. **Working capital** – you might need investment to manage your cash flow so that you have enough money in the bank. This gives you working capital, which is used to finance the everyday operations of your organisation.
2. **Bridging loan** – a one-off loan to bridge a bigger gap in cash flow. For example, if payments don't come in as expected, or there is an unexpected cost that needs to be paid. A standby or overdraft facility can also be used at such times.

Growth and innovation

You've decided you want to scale-up so you can:

- bid for bigger contracts
- sell your products and services to more people
- deliver a wider range of products and services
- deliver your products and services across a wider geographical area

All of which helps you to create more social value and change more people's lives.

Possible uses for investment

It's important to be clear about how you're going to scale up or innovate and what resources you need to do it. This could be, for example, to:

- Employ more staff to do more of what you're doing
- Employ specialists to enable you to bid for new contracts
- Invest in opening in a new location
- Pay for sales and marketing

To buy an asset

An asset is anything your organisation owns that is worth something – usually a building or some equipment that's vitally important in enabling you to do business, such as a bus for a community transport enterprise like HCT. For many organisations, the cost of renting their premises is the second biggest cost after staff salaries. Buying the building where you're based can be a good way to get some long-term benefit from money otherwise used for rent. You can also potentially rent out space to others, and benefit from any increase in value.

There are downsides: As with personal homes, buildings can also decrease in value and require ongoing maintenance. Also, not all organisations are fit to be social landlords alongside their core business.

In recent years, there has also been growing support for Asset Transfer. This is where a charity or social enterprise takes ownership of a building previously owned by part of the public sector; the building is usually one that is particularly valued by the local community.

Possible uses for investment

Examples of what you could use the money for include:

- Buying a building
- Renovating a building to get it to a point where it's useful
- Buying equipment to help your organisation improve its productivity

Mortgages to buy buildings are one of the most common forms of investment available to charities and social enterprises from both mainstream and social investors. Indeed, secured loans make up a significant proportion of the current social investment market.

Things to consider

There are six key areas to understand about your organisation before you should consider taking on social investment

Amount of money you need

This will impact the types of product you can take on and the type of investor you should contact

Revenue model

The critical element around taking on investment is the ability to repay it. Do you deliver activities that generate an income stream that will enable you to repay investors (and create a surplus to contribute towards sustainability)? You may have a range of activities, some of which generate income and a surplus, some could have customers in future, and some of which will always need grants to fund.

A clear income stream from sales of a product or delivery of a contracted service with enough margin to enable you to make repayments is essential. It's important that you're clear on your income streams and costs.

Business model and plan

It’s also important that you’re clear about your business model, and that potential investors can understand what your business is about from a quick glance at your plan.

You'll need to be able to show your track record of delivery, how well you engage with your community and/or people who use your services, and the level of financial and business skills within the organisation.

You will also need a clear sense of:

- What you do and who your customers are
- The products and services you offer and how profitable they're likely to be
- How many customers you have and who they are
- How you are different from your competitors
- Whether the market for what you do is growing or shrinking, stable or volatile
- How well connected you are to local or national networks and partnerships

Finance providers will judge the risk of investing in your organisation on the market that you operate in and the stability and predictability of your cash flow.

Social impact

As well as being able to effectively demonstrate your organisation's financial resilience and sustainability, you will need to show the social impact you’re delivering through your product or service. This is the key difference between social investors and conventional investors, such as high street banks.

It's important to know:

- Whether you have a clear vision of the impact you’re trying to achieve
- How you manage performance and measure impact
- How you report on your achievements and impacts

Guidance on measuring social impact for social investment can be found here

Legal structure

Certain legal structures, such as CLGs (Company Limited by Guarantee), prevent organisations issuing shares, which rules out equity investment, while others like CICs (Community Interest Companies) will restrict your rights to dividend (profit) distribution.

You will need to understand what types of investment you will or will not be able to access due to your organisation's legal structure. There is a diagnostic later in this factsheet which will help you with this. You may want to seek legal advice on changing your legal structure.

Time, resources and people

Taking on investment can be time and resource intensive. If you decide it's right for you, you need to set enough time aside to be prepared to report on and answer questions on your social impact, business model, legal structure and day to day finances.

Investors will want to see how you manage your finances including the systems you have in place, your knowledge of financial procedures, past and predicted cash flow and the extent of your internal financial reporting. If you have good systems and a strong track record, your organisation will be considered a safer investment.

Investors will also want to find out about the skills and expertise of your board members, staff and volunteers. Areas to focus on include finance, marketing, business development and legal.
It's important that your **board members** understand the opportunities and risks of social investment so they can consider whether it could help deliver your mission. The Get Informed campaign from Big Society Capital offers practical support, guidance and information for board members of charities and social enterprises.

What types of social investment are there?

There are two main types of social investment

Borrowing (debt)

Taking out a loan which you agree to repay over a set period of time. Most debt investments are paid back with interest - a fee you pay to the investor for the use of their money.

E.g. an investor loans your organisation £10,000 and you repay a total of £11,000 at £229 per month over 4 years.

Shares (equity)

Selling shares in your organisation to an investor. Equity investors receive a share of any profits paid out by the organisation and get to have a say in how the organisation is run.

E.g. an investor pays £10,000 to own 10% of your organisation.

For more detailed information on social investment types, have a look at the Good Finance website

Is social investment right for you

Good Finance’s diagnostic tool will help you decide.

It takes about 2-3 minutes to complete and it will ask you questions about your organisation and your financial needs. It is designed to help you understand if social investment is something your organisation should consider.

If so, it will direct you to the types of social investment that may be suitable based on the information you've entered. If not, it will provide you with some suggestions of actions you can take as an organisation to become ready for social investment.