

Mechanisms and options for the development of a capital market for social economy organisations: Social Ventures Australia response

1. Background to Social Ventures Australia

Social Ventures Australia (SVA) invests in social change. Over the last eight years SVA has worked with over 100 social ventures with proven track records in tackling the issues behind social disadvantage.

By partnering with these innovative, entrepreneurial ventures we know that traditional avenues for capital raising are not available to them. There is limited funding available to the social sector to help grow proven ventures, particularly to support the building of quality organisations through the provision of appropriate infrastructure funding.

One aspect of SVA's vision is that a new social capital market will need to thrive alongside traditional markets and we are keen to partner to deliver a new asset class to social investment. Through applying commercial thinking and developing innovative social capital models, the Australian community sector can help fund initiatives which prevent and address social issues more cost effectively.

SVA has historically used a venture philanthropy model and has also begun to develop new approaches to social investment. SVA was a catalyst in the establishment of the Social Enterprise, Entrepreneurship and Innovation Alliance (SEEI) and is working with Foresters Community Finance in leading development work on social finance models. This development work has assisted us to establish strong partnerships working arrangements and a pipeline process with other organisations in the sector.

In 2009, SVA played a pivotal role in orchestrating the GoodStart syndicate comprising four non-profit organisations - SVA, Mission Australia, Benevolent Society and Brotherhood of St Laurence. Through the development of a new social capital model, the syndicate was able to raise funds to successfully bid for 650 ABC Learning Centres and is now running these centres with business disciplines for social purpose.

Furthermore, SVA has structured and facilitated innovative social capital products including patient capital for social enterprises that create employment for people excluded from the labour market - Fair Repairs, Bonsai Social Firm and NQGS.

SVA also successfully delivered a scoping study that assessed the need and potential for a Community Development Financial Institute (CDFI) sector in Australia (commissioned by Department of Families, Housing, Community Services and Indigenous Affairs (FaHCISA)).

More recently, SVA has also begun research and development into Social Impact Bonds and tendered for the Social Enterprise Development and Investment Funds. Through this work, we

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have collated a wealth of information on social investment models both in Australia and internationally.

2. Developing the social capital market in Australia

Through SVA's experience and international research we have identified key areas that need to be considered and addressed in order to develop the social capital market in Australia.

- The social capital market in Australia is nascent. In the UK, one of the key drivers of the sector was the Social Investment Task Force, which provided a strategic framework shaping policy and encouraged an environment for social enterprises. In Australia, this new and emerging market will take time to develop and it is important not to over hype around the immediate potential for impact.
- Development of social investment models in the UK has taken at least 10-15 years. There has been a rapid evolution of models and approaches but this is essentially a 'greenfield' arena with early stage understanding of 'what works'.
- There needs to be flexible approach to new models of social investment, moving away from a prescriptive one size fits all. This is particularly important for Government in catalysing this market.
- There are a spectrum of investment models created to bridge the gap between traditional grant funding and commercial finance. The spectrum begins in the grant-making arena and evolves into more sophisticated models where mechanisms and vehicles are created to ensure the flow of money from various sources (be it private, public or philanthropic sectors) to the right investees, by offering a mix of social and financial returns.
- Innovative financial products such as quasi equity, soft debt, patient capital and social capital notes are being piloted as a way to bridge the gap in financing social enterprises, accounting for both social and financial returns.
- Government is a key stakeholder in capitalising and /or providing operational subsidies (USA social capital intermediaries needed an additional 20-30% to support ongoing costs associated with running a fund). However it is important that investment decisions are carried out by social capital intermediaries.
- There is an increasing trend towards sector collaboration, with public, philanthropic and corporate sectors pooling their resources (funds, human capital, networks, knowledge and expertise) to maximise impact.
- In the UK, establishing relationships with investment houses and superannuation schemes took between 2-5 years to secure. This cannot be done quickly as awareness raising is crucial.

- Different models of social investment are usually influenced by the initial motivations of each social investor. Understanding these motivations is crucial as it determines the return they want and the hybrid model they adopt (e.g philanthropist v commercial investor).
- It is important to establish effective tax incentives. In the US, the New Market Tax Credit Program (which permits tax payers to receive a credit against federal income taxes for making qualified equity investments in to CDFIs) has attracted over US\$16 billion to the CDFI sector since 1994. In the UK the Community Investment Tax Relief attracted little investment, this failure was attributed to its complexity and the limits that were placed on lending. The UK also introduced a new legal model for social enterprises called Community Interest Companies, with capped dividends and an asset lock. These were designed to encourage investment into the sector. In Australia there needs to be shift to a more innovative and sympathetic tax structure. An example of this could be that if a DGR social enterprise is unable to repay their loan that this can be converted to a donation..
- The legal structure of Private Ancillary Funds (PAF's) needs to be considered, for example looking at the ability of PAF's to make investments that provide both a social and financial return.
- Commercial lenders view social enterprises as too risky with uncertain income streams, lack of collateral, credit worthiness and requisite financial skills. Decisions by these lenders do not take into account potential social impact. In the US, similar funds are experimenting with capital guarantees on deposits made into CDFIs (hence if the fund doesn't achieve a financial return you still receive your initial investment).
- Trade Associations have played a critical role in the growth of overseas social capital sectors through developing policy recommendations and best practice.
- Culture change is required from funders, investors and social enterprises shifting the sector away from grant dependency towards an investment orientation. Investment readiness, due diligence and measurable social impact will be the foundations for this change of mindset.
- Intermediaries play an important and essential role in the development of a pipeline of strong ideas that will have impact and develop the market. They also provide critical capacity building and aftercare for social enterprises to ensure impact from investment.
- One of the key challenges in the absorptive capacity of social enterprises focussed on employment, is the lack of government contracts for the significant employment support costs required to enable the excessively long-term unemployed to gain employment. Social enterprises that siphon off large chunks of their profits to meet these employment support costs will be less likely to be able to repay social investors, hence are stuck in a catch 22 situation. If the government wishes to encourage employment creation for social enterprises to grow and scale and investors to fund them, then employment support cost funding should be required within the current JSA contracts. This doesn't need to be new money, just flexible use of current expenditure which acknowledges the inherent employment support costs working with the excessively long term unemployed.

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- Research carried out by SVA in 2009 into the funding gap for social enterprises found that most social enterprises were hesitant or unable to take on equity investments¹. The majority of social enterprises in Australia cannot accept equity investments due to their legal form preventing them from disbursing dividends. It is estimated that 50 per cent are incorporated associations and 25 per cent are companies limited by guarantee². Additionally there is some concern of social enterprise management around the loss of control of their organisations. A more appropriate alternative is a quasi-equity investment whereby the financial return is dependant on the operating success of the enterprise. SVA believes that over time, these forms of financing will close the funding gap that exists in the social investment continuum between grants and commercial investments.

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¹ SVA, Funding needs of social enterprises in Australia, November 2009

² Social Traders, Finding Australia's Social Enterprise Sector: Final Report, June 2010