

Social Firms Australia (SoFA)

Response to National Consultation on the Social Enterprise Development and Investment Funds (28 October – 3 December 2010)

SoFA is a not-for profit organisation creating employment for people with a mental illness or disability through supporting organisations to develop social firms.

A social firm is one type of social enterprise which:

- has an integrated workplace: between 25- 50% of employees have a mental illness, disability or other disadvantage
- generates the majority of its income through the commercial activity of the business
- pays all workers at award/ productivity-based rates
- provides the same work opportunities, rights and obligations to all employees
- provides a supportive working environment, building modifications required for employees in need of support into the design and practices of the workplace.

SoFA has a particular interest in responding to this Consultation as we work actively at the front line of social enterprise development in Australia and are very aware of the difficulty many not-for-profit organisations face in accessing capital in a timely, appropriate and substantive way to support the development of their social enterprises.

Questions

1.1 What lessons do you consider are most relevant and important from the perspective of overseas experiences in developing social impact investment?

Social impact investment is an evolutionary process. It takes time (many years) to develop what is a new market in Australia on both the supply and demand sides.

In addition to funding, it will require education, influencing, expertise, engagement of professional networks, strong evidence of impact and social and financial return over time and enablers.

There needs to be a flexible mix of fund approaches and products to reflect the spectrum of early stage and late stage market development. "Investment" implies financial return. We need to talk in terms of social returns as well as financial returns and funding approaches that are appropriate to the opportunities presented.

With small enterprises and particularly start-up ventures, debt finance may not be always appropriate where a hard asset base does not exist and revenue stability has yet to be realised.

1.2 Based on your experience, what do you consider the most significant factors in the Australian context that act as barriers for social enterprises to access appropriate capital and financial products?

Social enterprise as a concept means different things to different people. There needs to be very clear understanding of the definition being used as the inevitable broad range of interpretations in the early stages of a sector's development will lead to misunderstanding about financial investment and the role it plays. In the not for profit (NFP) sector, there is often a lack of clarity about what it means to run a commercially successful business without long term reliance on grant funding or donations. Business and commercial expertise and entrepreneurship is often lacking within organisations.

Therefore making the business case for investment is difficult and not broadly well understood.

1.3 What issues in the Australian context need to be considered in facilitating access to capital for social enterprises?

Definitional Issues – Parameters around funding allocations: clear social or environmental purpose organisations, compelling business models, strong management, and ability to demonstrate sustainable revenue over time.

On going support and Productivity Issues - There is ongoing discussion about the need for social enterprises employing people with significant barriers to work to access ongoing subsidy to offset a loss of productivity where existing supports and subsidies are not available. This should not be the purpose of the Fund/s.

Product Issues – early stage funds need to include a blend of grant and loan funds and the offer of engaged professional support and mentoring by the fund manager.

Late stage investments may lead to more sophisticated debt and equity investments.

Legal Issues – NFP constitutions may limit entering into equity instruments. The legal mechanism to allow for financial returns to investors/shareholders in NFP legal structures does not to our knowledge exist in Australia.

Reference UK community special interest company (CIC) or US L3C.

1.4 What are your views on market challenges and opportunities and the most appropriate mechanism to address them?

The social impact investment market in Australia is very early stage and little understood. There may well be a disconnect between current supply side thinking and likely demand. There is a strong background of enterprise development in certain states which provides an opportunity and challenge as there may be resentment if it appears more funding is allocated to one state than another.

A social enterprise development and investment fund or funds needs to be constructed to accommodate early stage market development as well as more mature and scaled investments over time.

1.5 What would be the greatest contribution to developing social impact investment in Australia?

Setting up at least one fund like FutureBuilders – express all of government commitment to facilitate and enable procurement revenue opportunities coupled with grant and loan funding and skills transfer to NFPs to tender for public sector contracts. There needs to be a parallel process of supporting social enterprises to be able to take on social procurement opportunities.

www.futurebuilders-england.org.uk

1.6 What obstacles exist to the absorptive capacity of social enterprises to utilize this type of funding and what steps would be most important to build absorptive capacity and confidence?

The evidence and transaction flow does not exist yet to give professional investors confidence that a social impact investment (whether it be financial first or social impact first) is viable. The proposed Funds need to be segmented or tiered to meet likely and varied demand opportunities:

1. Likely grant requests for up to \$50k. This demand is currently catered largely by philanthropic funders helping organisations with project based or early stage venture investment.
2. There is very likely to be a demand for start up grant and loan capital for new enterprise initiatives \$50k - \$350K. Many of these investments are likely to be unsecured with less stable cash flows and low commercial returns.
3. Government facilitated procurement \$50K plus a la Future Builders. Grant and loan. More certain and long-term security of revenue stream.

4. Over time and with social impact market development, there is likely to be demand for more mature growth opportunities and game changers in terms of impact that could attract multi-million dollar investments. Addressing issues like climate change, affordable housing and poverty. Larger procurement opportunities in government and health and education will fall within this scope.

These investments are likely to be secured against a valuable asset base, with the potential to generate significant wholesale returns over time. Debt and Equity.

Gradual development of social enterprise may result in more time required to achieve the desired social outcomes. It is critical that the commercial operations are not compromised by the social outcomes dominating over the need to ensure the business is being run to a high standard. There is a reputational risk to the sector if unrealistic social outcomes of employment and training are tied to the investment over a short time period.

1.7 What features of SEDIF would be most important to build capacity and enhance outcomes achieved within the social enterprise sector?

Clearly defined eligibility parameters. The purpose of the Fund/s should be to support social enterprises that are capable of long-term financial sustainability and should not be to replace government funded service delivery or support delivery.

Flexibility

Blend of grant, loan and equity

Engaged and supported

Reporting and measurement

Expert staff, board, advisory and partners of the fund/s.

Realistic timeframes

2.1 What would you identify as key success factors for the Funds?

Clear Guidelines and eligibility

Structured to meet likely demand and reflect early stage development of Australian market

Option to couple funds with professional support and mentoring if required.

Independence, experience and expertise of fund managers accountable to government and board.

Evidenced and transparently measurable successful investments.

2.3 What communication tools would be effective in describing the impact achieved through SEDIF?

Networked e-newsletter

National Investor forums/meetings

Press

Website

Employer Industry networks

Dissemination of reporting and measurement reports

2.4 What other factors could have a material impact on SEDIF achieving stated objectives?

- A Fund/s is developed that is too prescriptive and does not cater for likely demand or meet investor expectations
- A Fund manager is not properly accountable to the Trustees of the Fund
- Early "investment" return is not evidenced or investments fail
- Measurement tools are manipulated and do not accurately reflect performance of Fund "Investments"
- Need to be able to reach the audience and clear assessment process with business expertise involved
- Better to fund a few social enterprises well rather than lots of small grants (scatter gun approach)

2.5 What level of demand by social enterprises would you anticipate for growth and development capital delivered through SEDIF?

Depends on the structure of the Fund/s and investment readiness of applicants.

Timely and ready access to start up funds will greatly accelerate new enterprise development and ongoing demand for growth funds.

Could be a catalyst for more large-scale social impact investment longer term.

2.6 In which areas (geographic, population groups, or social need or change) could greatest social impact be made through this type of investment?

Employment and Education

Those furthest from the labour market – people with mental illness or disability, aboriginal people, early school leavers.

Any funding should look to support a triple bottom line approach where it can – financial viability, disability or marginalised employment outcomes and positive environmental impact.

2.7 What is the minimum size that would allow each Fund to operate on a commercially feasible scale?

Based on UK experience, early Funds opened at GBP 2-15 million.

2.8 What factors are most likely to attract additional corporate, private and philanthropic investors to invest in the fund?

Each potential investor will have different drivers. Useful to think about and identify Potential investors on a:

- Social return and impact only (grant) or
- Social impact first and below market financial return or
- Market financial return first with social impact

2.9 What type of products would attract investors?

Grants

Soft loans – unsecured, interest free with repayment linked to cash flow availability

Loans – sub market interest rates, unsecured with repayment linked to cash flow availability.

Loans – sub market interest rates, secured with scheduled amortisation.

Loans – market interest rates, secured with scheduled amortisation.

The interest rate market in Australia is largely floating rate but fixed rate options available. Need also to consider term of loans – 2-10 years.

Equity – sub market/market returns. Engaged investment. More flexible return and exit arrangements.

2.10 What range of returns would investors expect?

Investor return expectation for social impact investment will depend to a large extent on the:

Social drivers to invest

Market rate for alternative investments

Risk profile of the investment

Liquidity of the investment

Based on overseas experience, we know markets are being developed for below market returns in both debt and equity instruments supporting social impact investments.

2.11 What range or level of investment would private investors be willing to contribute?

The level of private investment will be linked to the return drivers listed above.

Most private investors will have a portfolio approach to investment with a view to spreading risk.

2.12 What track record should each Fund be looking to establish in order to attract future investment?

In the early stages, the Government's contribution to the Fund, and the reputation and competency of the Fund manager will be important to attracting matched or leveraged investment.

The Fund would need to grow on a controlled basis with evidenced successful investments based on a staged approach.

Typically 3 years of trading history is required in the debt markets to establish company viability.

2.13 How could the Government contribution be best utilised to attract these other investors?

The Government contribution of itself can be leveraged based on commitment to developing the social enterprise sector.

If government could couple the dollar investment with proactively creating contract opportunities to help social enterprises underpin viability, then that makes for very strong utility.

2.14 What mechanisms should Government consider to encourage the social impact investment market more broadly?

National investor road show showcasing market developments abroad, where the sector is heading, evidence of successful investments abroad and domestically both at the nascent and mature end of the social impact investment spectrum.

Agree a measurement tool or standards for social impact measurement.

Benchmarking tools to be developed and applied to the performance of the Fund/s.

Legal company structure changes when the market is more developed o make it easier to invest in NFPs. In the UK the community interest company (CIC) was created to provide an asset lock, so that assets can only be used to benefit the community and CICs can also issue shares and pay dividends. In the US, the L3C has been created to make it easier for foundations to make programme related investments into social enterprises as opposed to grants.

In Australia Social enterprises are typically run as divisions of NFPs (so as not to duplicate overhead) so legal recourse to investments will typically be via the NFP.

Legislate to corral unclaimed and dormant bank deposits, superannuation funds and gambling winnings for a social impact purpose.

2.15 What financial products would suit the needs of social enterprises now and over a longer timeline?

The financial products continuum will evolve with the development of the market.

At the small investment end, there is now a demand for grant and possibly soft loan or interest free loans on an unsecured basis.

With larger and asset based investments there will be an appetite and capacity to service more market based instruments.

2.16 What portfolio approaches could Fund managers take in regard to terms, interest rates, risk and range of products offered?

The Fund will need to be managed on a portfolio-based approach with a range of risk profiles to its investments.

Diversity of risk is reflected in type of investment, location, amount, borrower concentration, asset class, security, return, level of performing/non performing loans etc.

Risk assessment tools and benchmarking data needs to be agreed and made transparent.

2.17 What approaches to capacity building could Fund Managers take to enable social enterprises towards investment readiness?

Any funding should have the offer of professional support attached.

3.1 What would comprise the most appropriate mix of skills and experience in the management team?

Accounting
Financial and credit Analysis
Tax
Legal
Marketing
Government procurement
Not for Profit
Entrepreneurship

Advisory – charitable, foundations, private equity, legal, strategic

3.2 What opportunities could these partnerships generate for other capacity building support for social enterprises?

Access to contract revenue opportunities
Pro-bono support
Access to professional network support
Promotion media etc

3.3 What time frame do you anticipate Fund Managers would require to obtain financial licenses, appropriate status (i.e DGR) and regulatory authorisations?

3 months?

3.4 Which organisational models are best suited for the establishment of the Funds?

Charitable Trust?

Some sort of hybrid Trust between charitable and professionally managed fixed income fund?

3.5 What other structural issues need to be addressed to support Fund Managers to facilitate private, institutional and philanthropic investment?

Measurement framework.
How will the Fund/s benchmark performance? Against similar overseas funds/investments?

3.6 What programmes or approaches could be used to assess and develop “investment readiness” effectively?

Case by case approach.
Engaged funding – getting behind the numbers and social purpose.
Quality of management and the business case.
Professional assessment of likelihood of medium term viability.

3.7 How could the Fund managers obtain the required business and technical expertise in industry sectors?

Would have access to a consulting base and network of contacts and partners.
Could buy it expertise in on a project basis

3.8 What governance arrangements would be required by a Fund manager to set up and start operating the Fund?

If the Fund is raising money from the public to invest, there will likely be a trust deed, a management agreement and other legal documents governing the constitution of the trust and its operations.

The trust deed will need to set out clear investment policies and objectives, monitoring and redemption rights of investors and protections available to them/insurance.

Investment parameters should include credit quality of investments, duration of investments, liquidity of investments, diversity of investments, return parameters.

Reporting /surveillance framework

3.9 What risks are associated with the running of the Funds and what mitigation strategies could be put in place to address those risks?

Legal risk of trustees and fiduciaries to invest in a prudent manner when one has both social impact and financial return considerations.

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