Charities and social investment: an IVAR study

Work in progress briefing: Points from the literature

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IVAR
Institute for
Voluntary Action Research

1. Introduction

The Institute for Voluntary Action Research (IVAR) has initiated new research on small and medium-sized charities' experience with social investment. By concentrating on the voice of small and medium-sized charities and then communicating what we learn from them to charities and other investors as well as intermediaries, we aim to provide a bridge between these different actors in the field of social finance.

The need for improved mutual understanding between investors and investees was a key finding of our 2013 study into charities and social investment on behalf of the Charity Commission.

This new research is being funded by IVAR, Barrow Cadbury Trust and Access – The Foundation for Social Investment, and has the support of the Charity Commission[1].

At key stages throughout the research, we plan to share what we learn. This will include three main elements: a review of existing evidence for insights into the experiences of small and medium-sized charities; interviews with charities that have sought social investment; and with charity infrastructure bodies.

2. Appraising the literature

Our review of the literature has prompted a number of observations about research on social investment.

2.1 Charity voice

There is a gap in research, meaning that the voice of small and medium-sized charities (those with a turnover of £10,000 - £1million) is not being heard in the debate about social investment. As referred to in our initial proposal, there are 62,493 of these organisations in England and Wales compared to 4,137 large and major charities[2]. Of the 31 items included in our literature review, only two[3] involved direct consultation with charities and only our previous study for the Charity Commission concentrated on small and medium-sized charities. In addition, no material was found about charities that have been turned down for social investment.

2.2 Terminology

There is a confusion/elision of terms used in the research that is available. These include social sector, third sector, charity (incorporated, unincorporated, company), voluntary organisation, community business, community interest company, social enterprise (asset and profit locked/ asset locked/non-asset and profit locked), social entrepreneur, social firm, social business, B-corporation. Organisations falling within these definitions have different missions and funding models. It is difficult to interpret research findings and attach meaning to them if we are not clear what kinds of organisations have taken part, or are being referred to.

[1]Baker, L. and Goggin, N. (2013) *Charities and social investment: A study for the Charity Commission,* London: IVAR; Big Society Capital and ACEVO (2015) *What do charity leaders think about social investment?* London: Big Society Capital.

[2]NCVO *The UK Civil Society Almanac 2015*

[3] See 1 above

2.3 Market segmentation

Some basic analysis by market sector (arts, heritage and sport, natural environment, etc.) has been carried out by Big Society Capital. However, more detailed segmentation of the market would be helpful, both to social investors and to charities themselves. This would investigate the market by organisation size, funding sources, legal structure, charitable status, asset and profit-distribution locks, region, trading history, etc. Wider research into charity finance and financial capabilities has much to offer social investment research; it would be good to see social investment and charity finance research linking up together.

3. Lessons from the literature: small charities perspective

The literature suggests that the social finance needs and experiences of small and medium-sized organisations are different from larger organisations; and that small and medium-sized charities interested in social investment may find it harder to access. Below, we highlight three factors from the literature.

3.1 Mission

Charities' effectiveness is measured by their capacity to deliver on their mission, not on their investment-readiness. Some charities will never need to be investment ready, as that status is not relevant to their capacity to deliver on their mission. For others, investment readiness shows how they have opened up strategic and funding options and thus built their capacity to deliver. Investment readiness needs to be seen as related to mission, rather than a goal in itself.

3.2 Capacity

Smaller organisations can find it difficult to dedicate time and resources for negotiating with third party investors; and generating the kinds of impact evidence that such investors require. This contributes to limiting their access to finance[4]. The Futurebuilders Fund learned that organisational size, along with its stage of development, was related to the likelihood that an organisation would default on its loan. Organisations that defaulted had an average turnover of *'half the size of the rest of the closed portfolio'* and 67% of those who defaulted were 'start-up'/growth investments, '*compared to 30% in the rest of the portfolio, which was mainly composed of expansion investments*' [5].

[4]Moullin, S. and Shanmugalingam, C. with McNeil, B. (2011), *Growing Interest? Mapping the Market for Social Finance in the Youth Sector*, London: The Young Foundation.

[5]Brown, A., Behrens, L. and Schuster, A. (2015) *A tale of two funds: The management and performance of Futurebuilders England*, London: The Boston Consulting Group.

3.3 Demand

The demand for social finance within small and medium-sized organisations has also been discussed in the literature. For example, research into the activities of social enterprises found that organisations with a turnover of more than £1million were almost three times more likely to seek repayable finance[6].

Some of the reports that we reviewed suggest that there is a potential demand for social finance amongst some smaller organisations wanting to 'scale up' in order to achieve greater impact and greater economies[7]. However, the literature also suggests that there is a gap in the supply of the kind of higher risk investments – what Robbie Davison and Helen Heap refer to as *'builder finance'* – that this would require[8]. Moreover, in order to make a profit, there is an incentive for investors to concentrate on higher value transactions associated with larger, more mature organisations. Intermediaries can address these issues by designing funds that have *'an explicit goal to appropriately balance its service offering across large and small organisations at various stages of profitability and maturity'*[9]. The CAF Social Impact Fund has been given as an example of this.

This briefing is based on a rapid review of literature, published from 2012 onwards, that addresses social investment in general; and of a selected number of studies, published before 2012, for what they tell us about small and medium sized-charities in particular.

We welcome any comments or reflections about the experience of small and medium-sized charities, but we will be especially grateful for any insights into the experiences of organisations with an income below £100,000.

To contact the lead researchers, Leila Baker and Niamh Goggin, and to be kept informed about the research, please email: leila@ivar.org.uk

You can read the full research proposal and see the findings of the 2013 IVAR study for the Charity Commission here:

http://www.ivar.org.uk/news-events/news/new-research-charities-and-social-investment

[6]Lyon, F. and Baldock, R. (2014) *Financing social ventures and the demand for social investment*, Birmingham: Third Sector Research Centre.

[7]Ludlow, J. (2009) *Capitalising the Voluntary and Community Sector: A review for the NCVO Funding Commission*, London: NCVO.

[8]Heap, H. and Davison, R. (2013) *Financing Social Enterprise: The Role of Builder Capital in Funding Innovation To Address Social Need*, London: Seebohm Hill.

[9]Charities Aid Foundation (2011) *The Impact Investor's Handbook: Lessons from the World of Microfinance*, London: CAF.