Social finance - swimming against the tide?

It has been over five and a half years since the election of the Coalition Government which made growing the social investment market one of its priorities for civil society, and over three years since the creation of Big Society Capital – the institution primarily charged with supporting that goal. However as of yet, we haven't seen social investment become part of the mainstream of charity finance. Why is that?

Although for some organisations there are 'cultural' barriers to accessing finance – arguably the primary reason behind the lack of growth in the market is wider market conditions of the charity sector.

The recent NCVO, CFG et al financial sustainability review found that the charity sector's income has stagnated since the financial crisis and that technically, it is still in recession. This is primarily driven by a £2.3bn fall in government contract and grant income since 2009/10. With government income likely to continue to fall over the next five years and foundation grants or trading unlikely to make up for this reduction, many charities will find it challenging just to make ends meet.

Moreover, the current fundraising situation could impact on charities. Fundraising is one of the main ways that charities seek to generate 'unrestricted' income – this is money that could be used to pay off social investment loans. Seeking to pay off social investment loans via contracts, for example, can be challenging as this income is typically restricted and margins are small.

The upcoming Spending Review will be an important factor in long term planning for many charities. If the government reduces the level of austerity over the coming Parliament, this may encourage more charities to borrow to invest. However, if the Spending Review maintains cuts at the levels predicted in the last Autumn Statement or increases them to pay for additional tax cuts, this could have a negative impact on sentiment.

The challenge for social investment is how it adapts to the tough financial conditions that charities face on the ground. At present there is a feeling in the charity sector that social investment has been developed in a bubble - divorced from the financial situation facing charities. Organisations are only going to borrow if it is suitable given their financial conditions.

But as it doesn't appear that the financial situation for voluntary organisation or charities is going to get any rosier over the next five years, the social investment market needs to be able to answer some fundamental questions.

- How can it work in a low growth or no growth funding environment?
- How can it help charities to restructure their business models, where necessary, to achieve change?
- How can it both build up the capacity of charities, voluntary organisations and social enterprises to engage with social investment at the same time as getting money flowing out of the door?
- Is the market effectively spreading risk throughout these sectors or concentrating it?

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