Using head and heart

Mark Salway explains the thinking behind a major new research report on social investment.

ABOUT THREE YEARS ago, I was sat in a pub garden in Bournemouth with Professor Paul Palmer from Cass Business School. We were talking about the charity sector and I started to talk about my recent trips to Africa with CARE International. I told him that following the global recession, grants were reducing across civil society at precisely the time that charities' services were most needed.

I remember saying to Paul that I had been working with a Rwandan NGO which was running out of money. They had asked me to get them more grants, or a large donor to shore up their finances. Yet they were sat with a building they owned and we quickly came to a plan to rent out their spare space on a commercial basis. They had never thought in that way before.

We worked out that they could develop a business model which could underpin their charitable activities, and remove much of the need for new grant funding, just by leveraging the assets they already owned. They subsequently borrowed a little money to develop another building they owned and were flying.

At the same time, I was working with Water and Sanitation for the Urban Poor (WSUP). They build sustainable water and sanitation in African and Asian slum areas, where local people are happy to pay a small amount for water pipes or portable toilets to be implemented. Once the local authority sees that this is sustainable, they also invest and help the initiative to grow.

Unsustainable models

I firmly believe that the charity sector is precious because we help the hardest to help, and pick up the pieces of lives that fall through the safety net. But I fundamentally believe that many charities are not sustainable in their current business models.

I also believe that many charities have been using their reserves to see them through the tough times, rather than addressing their business models. Grants are precious and should be used thoughtfully, but in many cases I see that charities are trying to scale their operations using grants when it simply isn't the right business model for them. I even see charities which would rather close than change to address funding issues.

> "There is a cultural barrier to using investment tools in the charity sector"

With this in mind, I was proud to release my research paper, *Social Investment as a new charity finance tool: using head and heart*, last month. The report explains what social investment is and how it works so that charities can decide if it is right for them or not.

This is the result of two years of hard work. It follows a survey answered by 190 charities and funders around the trends in charity finance and social investment, and hours of number crunching and debating. It also follows a high-level symposium gathering thoughts and ideas from more than 100 leaders, a series of exploratory seminars on social investment entitled Demystifying the Hype, and more than 120 interviews.

What the research concludes is that charities want social investment and want to learn. They want new tools to help them grow and develop, although there are no silver bullets.

Charity finance strategy

Social investment uses commercial-style tools to fund charities and social ventures. The intent is to use any such investment to create both a social and a financial return. Charities then pay the capital back, either without interest, such as in a repayable grant arrangement, or with interest to compensate for the investor's risk.

However, social investment is just a tool. Therefore, to really understand its use, the report first looks at the landscape of charity finance and its sustainability.

The charity sector has seen a reduction in funding from its key income streams (grants, government contracts and donations) in recent years. By rights, therefore, we should be a sector under pressure as income has reduced and demand for services has increased. I was surprised to find, however, that many charities are not only reasonably confident in their financial strategies but also believe that they have appropriate reserves policies. This view is supported by literature that claims the sector is more robust than one might think. However, this is not uniform across the sector – small charities and those funded primarily from grants are feeling most pressure.

Survival and sustainability dominate the mindset of charities when they think about their funding. Equally, without predictable income streams, charities are unlikely to think of much other than survival; and that includes focusing on impact. If trustees equate financial stewardship with survival rather than focusing on impact, can this be good for the future of the sector?

What is also clear is that charities technically know how to handle grants and donations, but don't necessarily understand how this links to strategic objectives such as growth. Our research highlights that many charities don't consider the growth cycle of their work or services and often don't consider the type of funding needed to bring this to life. Funding needs to be structured around a charity's ambition and needs (see the diagram below).

Given that most charities have always focused on grants and donations, there is a great inertia. I have found there is a considerable cultural barrier to using investment tools in the charity sector. Charities feel conflicted when they think about investment and their organisations, and cannot see a link.

The picture is made worse in that finance directors mainly focus on finance and don't necessarily understand impact. They will need training to help them see the opportunities that different funding models could present for their organisations and how they can focus resources differently.

> "Smaller charities have less understanding of social investment than larger ones"

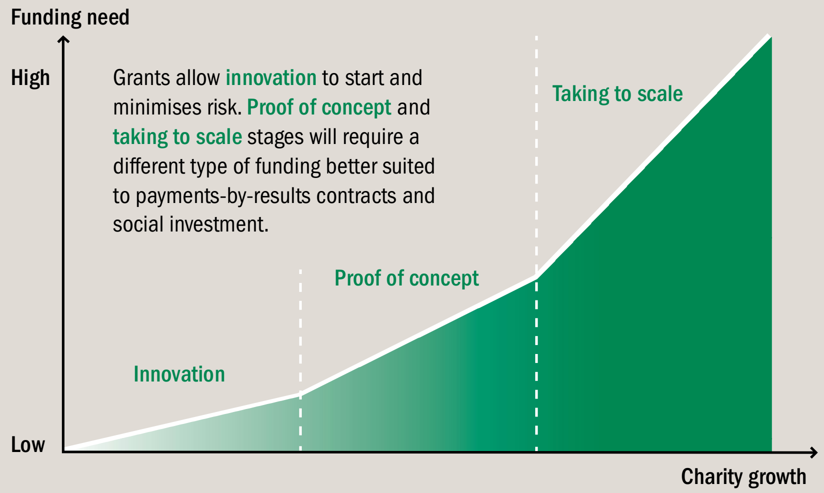
The social investment market

This is a market in its infancy, and we are developing market-ready opportunities. Many investors have raised concerns about the slow growth of the social investment market but any new market takes time and effort to build. We are on a similar trajectory to the microfinance and green investment markets, and our survey figures show a growth of 26 per cent per annum for the next five years. This is a growing and vibrant market.

Individual charities are in very different places regarding their understanding of social investment – this is highlighted by the broad spectrum of results in the survey. Understanding is highly correlated to the size of the organisation; smaller charities have less understanding than larger ones.

We also anticipate more social businesses developing which are not charities but which are using social investment to grow. I believe that we will also start to see the breaking down of the boundaries between charities, social enterprise and companies focused on delivering social value. Interesting times…

Funding models at different stages of a charity's evolution



Innovation
- Any financing should de-risk the innovation (allowing the charity to be successful and learn).
- Grants are perfect as they allow learning to take place in a secure and sustainable environment.

Proof of concept
- Impact metrics should have been developed and be measurable.
- Capital that helps an organisation deliver while passing on some donor risk works well, eg a blend of grant and social investment.

Taking to scale
- Monitoring and evaluation systems should be well-developed,and impact measures in place.
- Payments by results contracts, and social investment may be useful.

In conclusion

When I first started working for the Business School, I was asked if I thought that there were areas where social investment wasn't applicable. I answered animal welfare and emergency aid. Having now worked on social investment ideas in both of these areas, I know that social investment is here to stay.

Please pick up the report and dip in and out of it. Please use it to learn. I am glad that it is now out of my head and on paper. I hope it is impactful for the sector and helps to challenge business models so we all become more sustainable. ■

Mark Salway is director of social finance at Cass Business School and a former charity finance director