Social finance

Mark Salway explores how changes in social funding are impacting charity finance.

The world of social funding is changing and where there used to be clear divides between charities, social enterprise and profit-for-purpose commercial organisations, we are seeing the blurring of these entities and the focus on money that works not only to provide a financial return, but also has a social impact. Many organisations understand this dilemma well and focus their work either on creating social impact within a commercial setting or a commercial way forward for civil society, promoting financial inclusion and social enterprise, helping people to help themselves. However, not everything is about business and we should be careful to realise that emergency aid, for example, needs a primarily philanthropic led response, and that non-profit organisations with large reach and breadth of vision need to continue to advocate on behalf of the poorest and most needy in society.

Social investment

Many people ask, "what is social investment and how can it help my charity?" As one person succinctly put it, it's like normal investment with the word social added to it. Investment can be used as a tool to bring new funds to an organisation, take work to scale, develop innovation and build infrastructure, but remember that you always need to pay back the amount you have borrowed, with or without interest. For completeness we will use the following definition, coined by Big Society Capital: "Social investment is the use of repayable finance to achieve a social as well as a financial return."

Social investment is not appropriate for all charities, but ideally they should be empowered to see if a social investment model could work for them as part of their funding mix, and what this actually means. Understanding the cultural issues and challenges that will need to be overcome will be key to creating a dialogue around social investment. This will need to address the mindset of charity (caring, thinking with heart) and the mindset of commercial organisations (profit focused, thinking with head) to align with each other. This has been highlighted by some ongoing research by City University London as the key gap that needs to be bridged to facilitate different funding models for charities.

With the competition on fundraising income, the sharp downturn in government grants, the failure of some high profile charities and the continued pressure on overheads, charity finance models are being tested as never before. Social investment could play three key roles:

- To create impact for organisations through ensuring sufficient funds to undertake work.
- To ensure sustainability and viability of nonprofits.
- To provide a platform through which our sector's work can be scaled up.

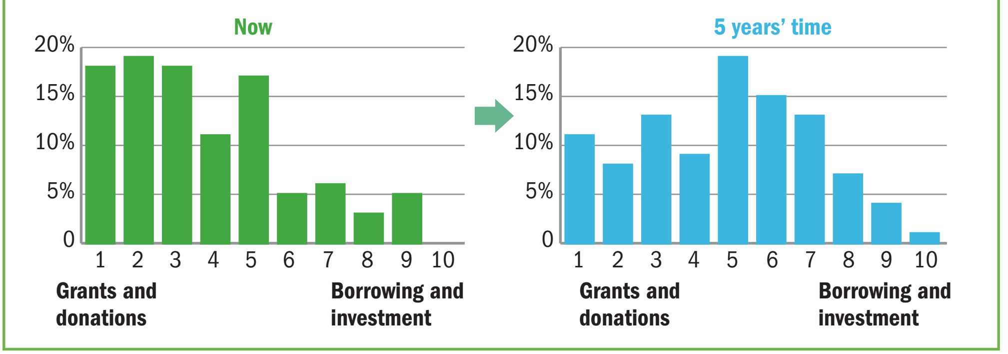
A change of approach

In November 2015, Cass Business School Centre for Charity effectiveness (Cass CCE) hosted an event along with Big Society Capital, CAF, CFG, Macquarie Group and the Worshipful Company of Management Consultants to consider charity finance and specifically to consider the potential impact of social investment.

To help look at changes in charity finance models charities were asked to complete a questionnaire. We received 188 detailed responses back from a good cross-section of different-sized organisations.

One of the key questions asked what does an organisation's funding model looks like now, versus what will it look like in five years' time. There was a considerable change in how non-profit organisations see their finance models now and in the future. The results are are shown in figure 1.

figure 1: Change from grants and donations to borrowing and investment from now to 5-years' time



Where grants and donations are prevalent currently, the responses reveal considerably more borrowing and investment in five years, quantified as around 12 to 15 per cent. What was perhaps surprising is that this pattern was consistent for small, medium and large charities alike. This is not to say that grants and donations will stop being the main form of funding for the sector, rather the sector is starting to embrace the use of social investment and borrowing as a tool.

Hearts and minds

There is also the issue of hearts and minds. A 2014 CAF survey – In demand: the changing need for charity finance in the charity sector – showed that while 71 per cent of organisations saw social investment as appropriate, only 30 per cent of trustees have a favourable view on repayable finance. Culturally it may take a considerable time for sector managers and their trustees to consider how these tools could enhance their business model and become comfortable with their application. The Cass research also highlighted that general understanding of social investment is the key barrier that needs to be overcome if social investment is going to be a meaningful part of the funding mix for the sector.

Charities have four main reasons to borrow:

- **Cashflow**
  Cash is king and borrowing to maintain cashflow is a necessary part of doing business for many organisations. Borrowing typically takes the form of a secured loan against the assets of the charity, or could be unsecured against grants or donations.
- **Asset purchase**
  Borrowing could be taken to help purchase a building or property, or purpose built facility which meets the needs of users.

Borrowing for cashflow and to purchase assets are part of the tools currently understood and used by charities.

Two new areas where charities could consider borrowing are as follows:

- **Fundraising**
  Some charities are starting to borrow money to leverage their fundraising which in turn allows them to have greater impact.
- **Funding a specific project or service**
  Investment funds could allow a charity to generate income which links either directly or indirectly to a charity's objectives. For example, a coffee shop in a library could generate revenue, or could be there to give a homeless person a job.

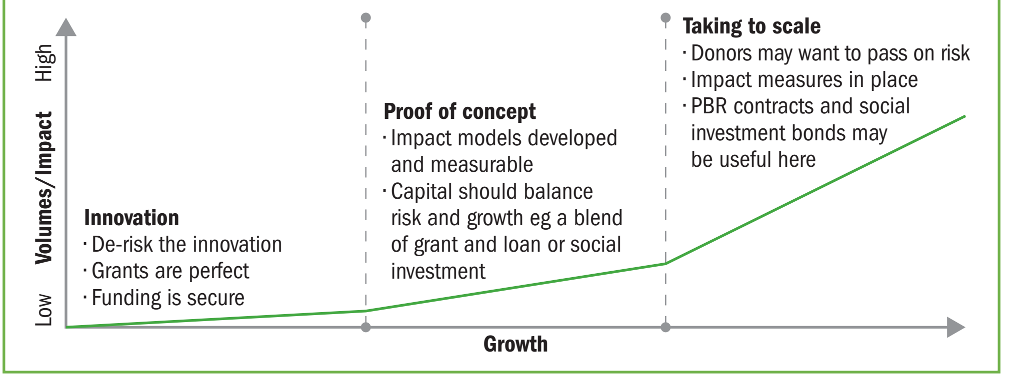
Business models are key. Equally investment doesn't necessarily have to be complicated. Maybe small unsecured loans are sufficient to leverage investment income into your charity. It may be worth considering your reserves policy and whether this could be relaxed to provide some investment capital. It may also be worth thinking about the stage of evolution of your charity, and while grants may de-risk initial innovation, investment funding may be far more appropriate to take your ambitions to scale. Crowd funding, peer-to-peer lending and other forms of social finance are new models of funding which can make resources available to drive impact. It just takes the will to think differently around a business model, and not necessarily fall back onto the grants and donations funding mix of the past.

Business models are key

Success will come to those charities which are able to understand their business model, and develop their strategic finance needs to fit with their objectives. Many charities are trying to achieve long-term shifts in behaviours. This may take ten to 15 years, or longer, depending on the nature of the problem and the issues involved. It is important to note that different financing models may well be more applicable to different points of a charity's (or a project's) life-cycle. Equally, some non-profits may have their focus on innovation, while others may be focused on taking interventions to scale.

Figure 2 illustrates this. Where a charity has an innovation focus it needs a funding model to de-risk the innovation, such as a grant. At the other end of the project life-cycle, when an organisation has a focus on taking its impact to scale, then a model where the charity takes on more risk (such as investment) could be more appropriate. It is worth noting that figure 2 does not imply growth per se. A non-profit may focus on its strategy for innovation or taking-to-scale or a mix of both. What is clear is that the funding model should fit the strategic focus.

Figure 2: Different forms of funding could be used at different stages



In summary

Charity finance is changing and the role of the finance director is becoming even more important. Ensuring sound financial stewardship and sustainability are critical roles that the finance director should play, however, really thinking about business models and finding an appropriate funding mix could become even more powerful.

Social investment is a new tool. It is not for every organisation, but could become a powerful tool to help the sector develop in future. The change that could happen within five years is considerable. However, understanding needs to be built and the mind-set of head and heart challenged for social investment to take root. Maybe now is the time to think about this when setting your charity's next strategy. ■

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