SPOTLIGHT PAPER

MIND THE GAP: SOLVING THE CHALLENGES OF ACCESSING CAPITAL FOR EARLY STAGE SOCIAL VENTURES

LOTTERY FUNDED

INTRODUCTION

SUMMARY OF FINDINGS

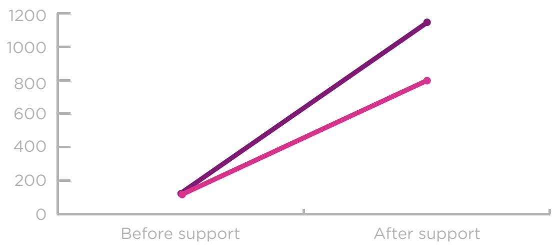
Social investment is an essential piece of the puzzle for social ventures with ambitions to scale their impact.

For many early stage social ventures, the social investment market feels embryonic, fragmented and difficult to navigate. A social entrepreneur needs significant support to access appropriate capital if they are to realise their vision for impact.

Providing intensive support to early stage social ventures is essential if we are to see them grow.

IMPACT OF INVESTMENT ON BIG VENTURE CHALLENGE'S SOCIAL VENTURES

All ventures on BVC:



Average number of beneficiaries rose from **114** before our support, to an average of **798** beneficiaries 12 months after our support and investment.

Ventures that received investment during BVC: average number of beneficiaries rose from **125** before our support, to an average of **1144** beneficiaries 12 months after our support and investment.

Social entrepreneurs are creating solutions to some of society's greatest challenges, but face challenges when scaling up and taking on investment. Since the creation of Big Society Capital – the £600m social investment wholesaler - in 2012, efforts to develop the social investment market have mainly focused on improving the supply of social investment.

There has been development and innovation in this sector, resulting in an increased supply of capital. However, there is little evidence of the expansion of affordable finance for early stage social ventures: between £50,000 and £250,000[1].

The supply of affordable early stage social finance is only part of the challenge. Efforts and innovations to help ambitious social ventures to be in a position to access this capital have been limited and inconsistent. As a result, even where appropriate capital has been available, early-stage ventures have faced significant barriers to becoming sustainable and to use investment to change lives and transform communities.

In 2013, UnLtd set up the Big Venture Challenge (BVC) programme - funded by the National Lottery through the Big Lottery Fund – to tackle this challenge. We supported social ventures with advice on what they really need in the early stages if they want to grow: strong operating capacity, a sustainable business model, growth in their client base, a robust theory of change and evidence of impact, and specialist advice. Based on their rapid development, the social ventures are then much better able to access the right kind of capital on the right terms to support their next phase of growth. In addition, we attracted new investors into the early-stage social investment market to expand the supply of social finance.

The programme has helped 120 social ventures to scale their ambition and their impact. They raised over £13 million in investment (including match funding from UnLtd). In 2016 alone, over 1.24 million people benefited thanks to the collective work of the BVC social ventures.

But the job is far from complete. With the BVC programme ending in April 2017, we believe that continued focus on the provision of social venture accelerators is vital, as is the provision of subsidised and appropriate capital for this market. This paper explores the early-stage social investment market and the challenges that persist for social entrepreneurs, and looks ahead to what the future holds.

WHAT IS SOCIAL INVESTMENT AND WHY IS IT IMPORTANT?

Social investment has an expectation of both a social and a financial return. Big Society Capital's research states that the UK social investment market is valued at least £1.5 billion, based on the social investments outstanding at the end of 2015.[2]

We think that social investment is a powerful tool that can lead to stronger, more sustainable social ventures. We helped 74 ventures during the Big Venture Challenge (62% of the total) to raise investment in order to generate greater impact.

Social investment is different from purely commercial investment. Social ventures have one main motivation: social impact. Social ventures aim for a sustainable business model, so that commercial growth creates long-term impact. Financial returns are, however, likely to take longer to materialise due to the focus on the delivery of social impact.

IMPACT STORY: THIRD SPACE LEARNING

Founded by Tom Hooper in 2013, Third Space provides online one-to-one maths programmes for primary school pupils in England. They find and train tutors across the world and link them to pupils in the UK in need of extra tuition. The aim is to solve the social attainment gap by providing targeted, cost-effective support.

In 2013, Tom was supported by UnLtd's BVC programme to raise investment to finance the launch of the online platform after testing. During the 12 months of the programme, Tom raised £470,000 including UnLtd match funding.

"The whole crew, ClearlySo and BVC and UnLtd, it was really helpful", says Tom, *"There's no doubt that it really helped. It helped give some validation to investors. I'm incredibly grateful for it."*

Following the programme Tom raised further investment of £2milllion from Nesta and the Social Venture Fund enabling them to expand internationally. A significant rise in turnover and number of staff means that Third Space Learning now works in 500 schools and supports 6,000 pupils a week. Over half of these pupils are accessing free school meals.

CHALLENGES FOR EARLY-STAGE SOCIAL VENTURES IN THE SOCIAL INVESTMENT MARKET

The social investment market is nascent and often does not meet the needs of social ventures, particularly those in the early stages of growth, typically between grant and secured investment. We call this gap in appropriate finance of between £50,000 and £250,000 for early stage social ventures the 'missing middle'. See the diagram below.

Lack of a proven track-record and assets

We know that for early stage social ventures, balancing social and financial demands is often complex and unpredictable. Without a proven track record, they require a higher risk tolerance from potential investors. Furthermore, most social ventures at this stage have few, if any, assets, so are unable to offer security as part of a debt deal.

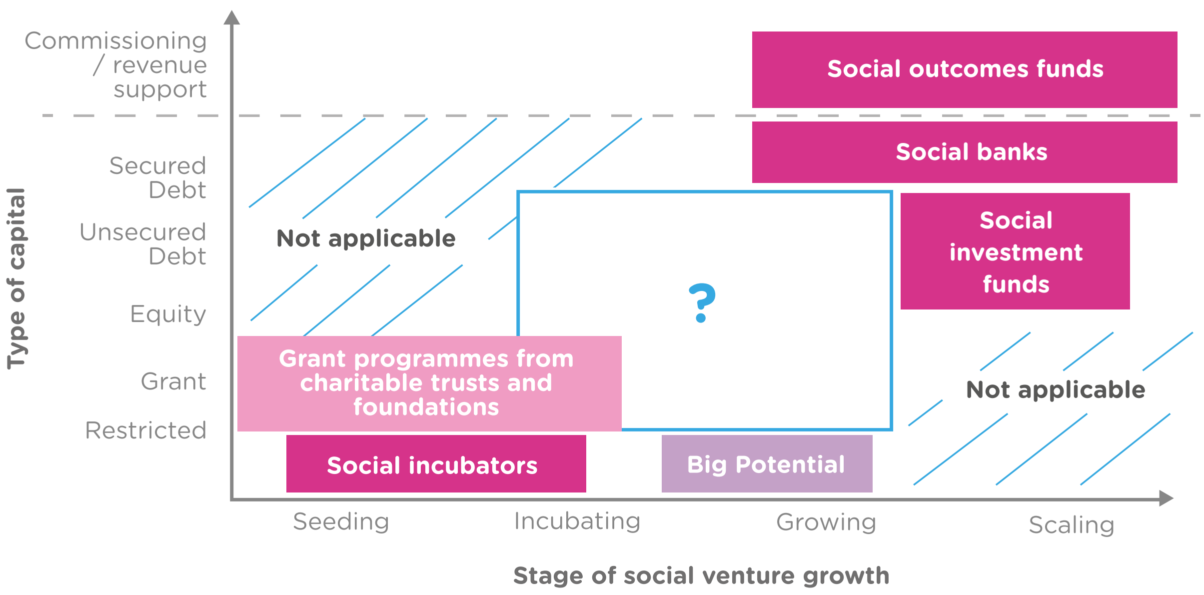
Increased risk and costs for investors

For investors, putting money into early stage social ventures is not just riskier, but also more expensive. Addressing both social and financial returns increases due diligence and monitoring costs to the investor. Equally, early stage social ventures tend to need funding of between £50,000 and £250,000, which are relatively small amounts for investors. According to Cabinet Office reports, many social investment funds cite transaction and due diligence costs averaging £5,000 per deal. If, as a social investment fund you have the choice of making ten deals averaging £100,000, resulting in £50,000 of sunk costs, or two deals at £500,000 with £10,000 of costs, it is hard to justify the extra cost of the smaller deals.[3]

We at CAF Venturesome know that social entrepreneurs need risk-bearing, flexible and affordable repayable finance, as well as grants, to help them to get their ideas off the ground. But, despite the huge growth in the social investment sector in recent years, there is not yet enough supply of this type of capital. Most social investors can find it too costly to provide the relatively small amounts (under £100k) of social investment, at a genuinely affordable price, which is most needed by early stage social enterprises. Until this supply gap is fully addressed, social enterprises will not be able to grow, thrive and achieve the scale of impact they want to.

Holly Piper, Head of CAF Venturesome

THE MISSING MIDDLE OF SOCIAL INVESTMENT



SOLVING 'THE MISSING MIDDLE'

There have been positive developments in the social investment market in recent years.

Big Society Capital reported in 2015 that the total value of social investment deals have more than doubled in value since 2011, representing roughly a 20% annual growth rate.[4]

The challenges faced by early stage social ventures are better understood and recognised, which has led to ongoing market developments, such as the establishment of Access Foundation – designed to increase the supply of capital to social ventures between £50,000 and £150,000 through their Growth and Reach Funds.

However, we want to see these efforts on the supply of capital matched by interventions that help social entrepreneurs get ready to grow their ventures and begin to make a difference at scale. Such interventions are rare, yet highly sought after by social entrepreneurs.

"Money is relatively easy to get a hold of, but real meaningful support isn't, that's what makes Big Venture Challenge and UnLtd essential."

Social entrepreneur

INTENSIVE SUPPORT TO HELP SOCIAL VENTURES REACH THEIR POTENTIAL

We believe that the provision of appropriate and intensive growth support for social ventures must be a fundamental part of this market. It will help to unlock the ability of social ventures to grow and scale their impact.

Following research, we found that there were common barriers faced by early-stage social ventures: accessing routes to market; access to talent; and finding sustainable revenue streams[5]. Through programmes like BVC we aimed to use intensive support to break down these barriers.

"The whole system of investment was something I knew nothing about. That's pitching to investors, understanding what investors are looking for, understanding different types of investment and so on, was something that was completely new to me."

Social entrepreneur

HOW WE SUPPORTED SOCIAL VENTURES AND STIMULATED INVESTMENT THROUGH BVC

What we did for social ventures:

- Tailored support to enhance the sustainability of each venture provided by an UnLtd Venture Manager. Support typically focused on:
  - Business planning and financial modelling to create a realistic growth plan;
  - Operational capacity;
  - Routes to market;
  - Governance;
  - Social impact measurement.
- Ventures were better placed to decide whether they should seek social investment and were in a better position to access early stage capital.

What we did for social investors:

- Help with finding high-quality social ventures to invest in;
- Support in completing due diligence on social ventures seeking investment;
- Making investment a less risky proposition by providing support to the social ventures to help them become more commercially sustainable businesses.

The power of this support is demonstrable. We supported 120 ventures in total, 93% of the ventures are still operating and, in 2016, a greater proportion of these social ventures grew their turnover than among mainstream SMEs.[6] This led to an average increase in the number of people they helped from 114 before our support, to 798 in the 12 months following it.[7]

We supported 74 social ventures to raise an average of £177,000 of investment each (including match funding). This support has enabled social ventures to access finance and support which they wouldn't otherwise have had access to.

"Our infrastructure is much stronger following the addition of an advisory board, senior managers and strengthening of our regional management team"

Social entrepreneur

"We worked with this really great Venture Manager who guided us through the whole process of getting our finances right, our forecasting right, our budgeting right. Through that we raised investment which helped us to move into new premises."

Social entrepreneur

The value of intensive support is clear, but who should pay for it is not. Given the already tight margins and long lead times involved in lending to early stage social ventures, social investors often consider intensive support non-essential and it is therefore squeezed. Equally, social entrepreneurs are unlikely to meet these costs when their businesses are at such early stages.

THE NEED FOR BLENDED CAPITAL

It is difficult to see the early stage social investment market operating without a degree of grant subsidy and blended capital – the use of philanthropic funds and private investment. Boston Consulting Group's research on the Futurebuilders Fund, which provided loan financing and grants to social ventures, highlighted the need for subsidisation. The Fund invested £145 million in loans and grants into 369 organisations. The loans that were paid-down or written-off led to investors receiving on average 3% less than the original investment. Despite the negative returns, this is a huge improvement to the use of grant capital in terms of financial sustainability in this market.[8]

We provided match funding to ventures on the BVC programme against external risk capital they raised. This was used to incentivise investors to put money into the social ventures where they may otherwise have been put off due to the high risk and costs associated with early stage social ventures.

"We effectively view it as additional grant money into the organisation, which is therefore strengthening their profit and loss, which makes our social investment less risky. We believe the match-funding element is one of the most important parts of the BVC programme."

Institutional investor

It also ensures that social ventures can access additional finance without having to sell a greater proportion of their ventures or taking on supplementary debt which could have future cash flow implications.

"I think that it's difficult to know whether the organisations who go through [BVC] would have obtained investment later anyway... I suspect in a number of cases that probably wouldn't be the case and in a few others, they probably wouldn't have survived. I think BVC is helping to accelerate growth of really great social businesses that probably would have otherwise just done okay."

Institutional investor

"The support from the BVC programme has enabled [us] to secure investment and scale-up by employing the second Co-Founding Director on a full-time basis."

Social entrepreneur

IN TOTAL, BVC SUPPORTED EARLY-STAGE SOCIAL VENTURES TO ACCESS...

£8,669,877

of external risk capital and an additional...

£4,437,500

of match funding

£4,718,877

of this total was new social investment into the sector

WHAT'S NEXT FOR THE SOCIAL INVESTMENT MARKET

The future of support for early stage social ventures

Though the supply of capital is improving, without programmes such as BVC, we believe the market will struggle to overcome two remaining challenges:

1. Absorbing the costs involved with finding and supporting social entrepreneurs to grow sustainable social ventures capable of raising appropriate investment to scale their impact
2. The cost of operating early stage social investment funds that meet the needs of early stage social ventures.

Investment readiness and capacity building programmes such as Big Potential and Access Reach Fund are welcome additions to the market. However, we do not believe that these are sufficient in what is a hugely complex market.

We want a fully operational and efficient market. To get there we need different players across the market to collaborate to ensure that ambitious social ventures aren't held back. Without being able to access early stage investment, high quality, social entrepreneurs will not be able to grow their ventures to a scale where they are applicable to the larger funders in the market.

We believe that social investors, support providers and policy-makers must make support provision a priority. This can be directly tackled through separate accelerator programmes, or within existing funds. Investing in support provision for social entrepreneurs is fundamental if we want to see genuine impact at scale from sustainable social ventures.

Authors: Ben Smith, David Bartram, Tom Fox
Date: May 2017

1. After the Gold Rush: The Report of the Alternative Commission on Social Investment (2015)
2. The size and composition of social investment in the UK (Big Society Capital, 2016)
3. Cabinet Office, 2011. Growing the Social Investment Market: A vision and strategy
4. Big Society Capital: Social Investments Insights
5. UnLtd: Going Mainstream: https://unltd.org.uk/wp-content/uploads/2015/11/UnLtd_Going_Mainstream.pdf
6. Department for Business, Energy & Industrial Strategy (2016), Statistical release 2016, www.gov.uk/government/uploads/system/uploads/attachment_data/file/559219/bpe_2016_statistical_release.pdf
7. Based on available data for 92 ventures
8. Oxfam Discussion Papers: Impact Investing: Who are we serving? www.oxfamamerica.org/static/media/files/dp-impact-investing-030417-en.pdf