Social Investment Tax Relief consultation

Evidence submitted by UnLtd, The Foundation for Social Entrepreneurs

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UnLtd is the Foundation for Social Entrepreneurs. We find, fund and support social entrepreneurs - enterprising people with solutions that change our society for the better. We were formed in 2002 by seven organisations who believed that social entrepreneurs had a much bigger contribution to make to our economy and society. We were among the first to back individuals with their own ideas to create social good.

Since we were founded, we have learned a lot about the barriers social entrepreneurs face as well as what they need to help them create the change they want to see. As we helped early-stage social entrepreneurs start up, they have told us that whilst our support is great to help them get off the ground, they face substantive challenges and a lack of investment when they are trying to scale up their operations. To respond to this need, we have launched our accelerator and investment funds:

- Between 2013 and 2016, UnLtd ran the 'Big Venture Challenge' programme which supported 120 social ventures through a 12-month accelerator offering intensive growth support. This programme was designed to stimulate the early stage social investment market and used £4.4m of grant / repayable grant to leverage in over £8.5m of external investment for these ventures.
- In late 2016, UnLtd launched the UnLtd Impact Fund – a £2.8m blended debt and grant fund designed to support up to 35 social ventures operating to reduce barriers to employment for those distant from the labour market.
- In 2018, UnLtd launched the Thrive Fund – a £2m debt and equity fund for early stage social ventures who have been through UnLtd's Thrive Accelerator.

This work has given us an extensive understanding of the social investment landscape and the challenges social entrepreneurs face when trying to access investment.

We welcome this consultation and the Government's commitment to improve the social investment sector. It is much needed, especially for social ventures seeking investment of up to £500k. Whilst we are responding to most consultation questions in numerical order, we have highlighted our key contributions in the first few pages.

Executive summary – Our key policy recommendations

We welcome the Government's consultation on Social Investment Tax Relief and its commitment to improve the social investment sector.

SITR should be about attracting new investors into this market but in our experience, few can get over the hurdle of the definition of a 'social enterprise'. **The premise and structure of SITR is a positive development for the sector, the issue is in the enterprises eligible for it and therefore how widely this has been taken up.** Very few early stage social investment funds can operate sustainably (even with the tax relief) if restricted to asset locked investments, and deal flow is so hard to come by.

To unleash SITR's potential in bringing more capital into social ventures, **we are asking the Government to:**

- **Open up SITR to mission-locked entities, not just asset locked ones.**
- Address the lack of investor awareness around Community Interest Companies (CIC) by **investing in education and awareness-raising.**
- **Reconsider the £15m asset limit** as it prevents asset rich but otherwise cash poor social ventures from accessing SITR.
- **Remove the 30% maximum ownership restriction when investing in debt.**

Whilst we are welcoming the Government's commitment to use tax incentives to create change, we believe **there is a lot more to do to support more funding for social ventures.** We are calling on the Government to help **shift the wider landscape of social investment to put social ventures' needs at its heart by:**

- Encouraging and investing in **more innovative, flexible and patient capital, including equity and equity-like offerings**
- **Expanding the support and investment into profit with purpose entities which have a mission lock** (whilst continuing to offer social investment to asset locked entities)
- Recognising the value of and **investing in pre-investment and post-investment support for social ventures,** as our research has revealed its importance in helping social ventures scale up
- Helping to **create a much more joined up, transparent and efficient ecosystem for all parties.** This should be anchored around the purpose, needs and potential of social organisations and their beneficiaries.

UnLtd is part of the Future of Social Investment Coalition (which includes the Government's Inclusive Economy Unit) that is aiming to tackle the four above-mentioned issues. We look forward to the Government's continued support of this work.

The wider ecosystem of social investment

We welcome the Government's commitment to review the SITR scheme. We have outlined our evidence and recommendations above and below for the relevant consultation questions. However, SITR should not be only looked at in isolation. We believe it's essential for the Government to consider the wider landscape of social investment as part of this consultation.

Our work as part of the Future of Social Investment Coalition - together with Access Foundation, Big Issue Invest, CAF Venturesome, the Government's Inclusive Economy Unit, Key Fund, Social Investment Business, and The Young Foundation - has revealed the following learnings, which are also being actively shared with the Impact Investment Institute and other stakeholders:

Learning #1: understanding what appropriate capital is

The social investment sector is still relatively nascent. As such, financing structures, time horizons, return expectations and skills have not had time to adapt to impact-first models.

We do not believe that we yet have investment that is flexible or patient enough for enduring social change.

Charities and social ventures tell us that the next wave of products and services need to be that much more innovative, flexible and patient, including equity and equity-like offerings.

Learning #2: there is a lack of capital for non-asset locked social ventures

We recognise that the needs of early stage social ventures growing rapidly are likely to be different to those of established charities seeking to develop earned income models. This is true both in terms of the support sought and the investment products required.

Social investors are often constrained by who they can fund, having to invest in social organisations with asset locks (charities and CICs). However, the delivery of social impact is not limited to such structures – UnLtd found on the Big Venture Challenge that social ventures which were 'profit with purpose' achieved greater impact growth than those which were asset locked.

It is important that we continue to offer social investment to asset locked entities and that we expand the support and investment into profit with purpose entities which have a mission lock.

Learning #3: there is a lack of support and sustainability for intermediaries

Social ventures thrive when given great support. This can be business support – in terms of their team, business model, product-market strategy, impact evaluation – but also specialist advice from e.g., legal or branding experts. In addition, connections and routes to market (clients, commissioners) and capital (investors, advisors) are vital, particularly when these can be complex and inaccessible.

Significant support has been provided for 'investment readiness' interventions over the last decade. Access' Reach Fund is refining these models to develop a better knowledge base around the necessary levels of subsidy for this sort of intervention.

Many players are also developing programmes to support charities and social ventures to grow earned income models which may require investment as they grow.

There is also post-investment support – accompanying organisations as they grow their impact and embed investor expectations and opportunities.

Pre-investment and post-investment support often require resources which are not built into most investors' models. As a result, many intermediaries struggle to secure funding for the sort of support they would like/need to provide their investees.

This support can be even more challenging to fund at the high growth start-up end of the market – where the social organisation (and intermediary) may not yet be able to demonstrate the compelling impact, established revenue base and profitability (and thus returns to the investor) for a few years. Equally, social organisations are unlikely be able to afford to repay their capital as well as the costs of the intermediary in these circumstances.

However, this pre- and post-investment support is vital, valuable work which benefits the whole ecosystem greatly e.g., for the 120 social ventures on UnLtd's Big Venture Challenge average turnover grew 166% over two years, and impact grew 600% over the same period, reaching 1.24 million beneficiaries; 74 raised £8.7m of investment.

Pre-investment and post-investment support has an important role in helping social ventures successfully scale up. This role should be recognised and more funding should be available for these activities.

Learning #4: there is a lack of cohesion and transparency

The tight margins, fragmentation and challenging funding environment for intermediaries mean that they have not been able to invest in the infrastructure and systems which are needed. This means that there is an unintended opacity around data, models, methodologies and impact. It also leads to a fragmentation of offers, with infrastructure being duplicated.

This all makes the intermediary sector sub-scale and difficult for social organisations to navigate and sources of capital to really value.

A number of key initiatives have sought to help charities and social ventures to navigate the market including Good Finance.

The Connect Fund is working to instil collaboration between intermediary and support organisations working to better connect charities and social ventures to the social investment market.

We need a much more joined up, transparent and efficient ecosystem for all parties. This should be anchored around the purpose, needs and potential of social organisations and their beneficiaries.

Question 1

If you are a social enterprise, are you interested in or planning to scale up? How do you intend to achieve this and how much do you hope to raise in investment?

Please see relevant case study on an UnLtd-supported social venture's experience in scaling up:

The Grace Network is an UnLtd award winner social venture that creates life changing opportunities through the medium of business. They are a social venture that conceives, launches and grows social businesses that can create work for the most vulnerable in society. Once they grow a business, they allow the newly trained staff to take ownership and develop the operation as directors. They do this from their base in Brimscombe, where they operate a hub (providing space, facilities and support) that allows social ventures to grow and develop.

They wanted to scale up in order to:

1) help more people;
2) increase the depth of their impact: to help people in a more significant way (for example being able to provide a full-time as opposed to just a part-time job for someone distant from the labour market who is ready for a full-time job);
3) reach a level of profitability where they can become fully sustainable.

They have scaled up through the following investments:

1) A grant worth £40,000
2) SITR – planned to be £60,000, but they have only raised £10,000 out of that
3) A £30,000 loan from UnLtd

In their experience grant funding is not ideal for a number of reasons like strict timelines and having to navigate relationships with grantmakers. They needed a nimbler way. In their experience the Unltd model worked really well as it was a more collaborative approach.

They found it easy to access SITR: they used Big Society Capital's guidance and they were able to use the BSC drafted documents which were immediately accepted by HMRC. Please see more evidence on their experience with SITR in question 13.

In January 2018 they had 11 staff and monthly turnover £13,000. As a result of their scale up efforts they now have (June 2019) 24 staff and £32,000 monthly turnover.

Question 2

Other than individual investors, what sources of finance do trading social enterprises seek and acquire?

Since 2013 UnLtd has invested in over 85 social ventures with more than £5.5m of investment, and we have supported even more to access investment from elsewhere.

In our experience the majority of trading social ventures seek personal investment, take out directors loans etc. and get money from friends and family because of the challenges in the sector. There are also some who seek and acquire finance from intermediary organisations and foundations, such as UnLtd, CAF Venturesome, Big Issue Invest, Esmee Fairbairn Foundation, and Joseph Rowntree Foundation.

Question 3
How difficult or easy is SITR to access for social enterprises?

In our experience there are few challenges for social ventures to access SITR. Big Society Capital has an excellent campaign which supports social entrepreneurs in accessing SITR.

Rather, the problem is on the supply and investor side -for further information please see our response to question 14.

Question 4
What are the factors that lead to a successful trading social enterprise?

UnLtd's research with 389 respondents has revealed that the 5 biggest challenges social ventures face are the following:

- Finding sustainable revenue streams
- Making a living from a social venture
- Finding routes in to sell to the public sector
- Getting access to the right kind of finance
- Getting access to the right talent and skills

These factors are crucial to help social ventures succeed.

Question 5
Do you think social enterprises need private investment and for what purposes?

We know the majority of organisations, social or otherwise, need to invest in their business to grow their operations more rapidly than organic growth would enable. This is no different for social organisations, and is often even more so to enable them to complete in commercial markets. For example, they would like to invest into resources and infrastructure to increase capacity and take advantage of a market opportunity ahead of competitors. The challenge is that the investment available comes with the same conditions on timeframes, cost, security etc. than it does for purely commercial entities, if not more so (because of the need to evidence impact).

Please see detailed case studies on why social ventures wanted to scale up and how they have achieved it in question 1 and 13.

Question 6
Is tax the most appropriate government lever for supporting funding for social enterprises?

We believe tax incentives are one way for the Government to help create a more enabling environment for social ventures and therefore the Government should continue looking at tax incentives.

However, tax incentives alone are not enough to create change. We believe there is a lot more the Government could do to support more funding for social ventures such as:

- Creating further endowments for impact investment
- Better subsidise the market to offset the high cost and risk of social investment (such as has been done through the Access Foundation)
- Distribute dormant assets and other available funding to organisations like UnLtd to invest in social ventures
  - These organisations not only offer investment but also a package of support wrapped around the needs of the social venture which is regarded as highly valuable by the ventures in overcoming the challenges around scaling up
- Level the playing field in Government procurement – for our specific policy recommendations, please see our submission to the Social Value consultation

Question 7
What criteria would be the best measure of success for SITR?

UnLtd would like to propose three measurement criteria:

- The number of organisations and investors using the relief
- The value raised
- The effectiveness of the use of finance: impact measured by tracking an organisation's change in number of beneficiaries, depth of impact and turnover.

Furthermore, alongside these metrics, a study would be useful to look at the following points to gain a more in-depth understanding of behavioural change:

- Investor behaviours and whether it was the SITR or general sector trends that made the shift or both
- A review of SITR vs. non-SITR social returns to evaluate whether the funds are generating beneficial returns
- A review from investees as to whether or not they feel it made them more attractive

UnLtd would be glad to assist the Government in further developing these metrics.

Question 8
Is the SITR limit of £1.5 million appropriate?

It's difficult to say based on our evidence, but we believe it is significantly more appropriate than the previous one:

The £1.5m limit is far more attractive to ventures. The previous €344k limit, which contributed towards State Aid was very unattractive, particularly when asset locked organisations which access SITR would favour (and have greater access to) grant income, which might be subject to State Aid. As a result, they would prefer to spend their State Aid limit on grants than investment.

Question 9

If you are an investor, have you made an investment that was eligible for SITR? If not, why not?

Out of the 74 ventures UnLtd has invested in over the last 6 years, there was only one who raised through SITR – HiSBe, a social enterprise supermarket. In November 2016, they raised a total round of £190,000, including £20k BVC match funding. This comprised £71k from 19 individual lenders using SITR. Please see more a case study on their evidence in question 13.

We have not been involved in any SITR deals since as we did not encounter more organisations interested in the scheme.

Question 10

Would you invest in social enterprise without tax relief?

Yes, and since 2013 UnLtd has invested in over 85 social ventures with more than £5.5m of investment.

Between 2013 and 2016, UnLtd ran the 'Big Venture Challenge' programme which supported 120 social ventures through a 12 month accelerator offering intensive growth support. As part of the programme, organisations had the opportunity to access match funding (comprising grant and repayable finance (in the form of a Revenue Participation Agreement)) against external risk capital. The accelerator was successful in supporting 74 social ventures to access over £13m of investment, from over 170 social investors, 30% of who were new to social investing.

In late 2016, UnLtd launched the UnLtd Impact Fund – a £3.2m blended debt and grant fund designed to support up to 35 social ventures operating to reduce barriers to employment for those distant from the labour market. One year since making its first investment and the Impact Fund is ahead of deployment schedule, having made over £1.4m investment into social ventures, who have collectively created over 7,500 job and training opportunities in the last year alone.

Furthermore, in 2018, UnLtd launched the Thrive Fund – a £2m debt and equity fund for early stage social ventures who have been through UnLtd's Thrive Accelerator. We have made 5 investments to date.

Question 11

What are your expectations when you invest in social enterprise? For how long do you expect to invest? Would you expect/prefer to invest in equity or debt?

UnLtd does both debt and equity investment and our expectation is to get a full return on our money.

We'd like to highlight the following elements of social investment which we believe are essential to help social ventures successfully scale up:

- Need for investment over a long period of time, to allow for growth, and not restrict it through funding requirements.
- Need to have funding for pre and post investment support, to allow social ventures to compete in commercial markets and to level the playing field for them – please see Learning #3 on page 4 for more context.

- Need for new product innovation. Social investment is predominately a debt market and there need to be ways to create new social equity (or equity-like products) in the market. It's not a choice between debt or equity. Rather, we need a market that meets the various different needs of social organisations, so not just debt.

Question 12
Have you used, or considered using, the Enterprise Investment Scheme or Seed Enterprise Investment scheme for impact investing?

We have never used these schemes directly through investing, however, we have match funded against risk capital raised using both the Enterprise Investment Scheme and Seed Enterprise Investment Scheme. In our experience these schemes are more widely used because they are more established and easier to understand, as well as being less restrictive in who can access them.

Question 13
If you are a social enterprise, would you use SITR? If not, why not?

Please see relevant case studies on an UnLtd-supported social ventures' experience in using as well as opting not to use SITR:

HISBE Food is an UnLtd award winner social venture. They are a new type of supermarket, built and run on a purpose-led 'social enterprise' business model, for the benefit of local people, local economy and local community. HISBE Food is on a mission to transform the food industry, by reinventing the way supermarkets do business. They are bucking convention, flipping the out-of-date mainstream supermarket business model on its head and seeking to make good food and good business the new norm in food retail.

Their pilot store in Brighton has now been trading for 5.5 years and they have turned over almost £7 million. They spend at least half of that in the local economy and give 67p in every £1 they take to their suppliers. They are now ready to replicate and want to build a local chain of ten stores in Sussex in the next five years. Over thirty years they intend to build a national supermarket chain that truly transforms the food industry by enabling shoppers to access and afford good food.

They raised money for expansion through SITR which they have called 'a fantastic scheme and a very effective financial tool, as it's cheap for them and very attractive for the investor.'

They have raised £71,000. As a result, they were able to employ a person who started working on expansion and they also did a rebrand to upscale their branding and marketing. Furthermore, they also redid their store – all of this to make it replication and expansion ready.

Their plan now is to go back to their network when they find another shop and raise around £100,000 again through SITR.

The Grace Network is an UnLtd award winner social venture that creates life changing opportunities through the medium of business. They are a social venture that conceives, launches and grows social businesses that can create work for the most vulnerable in society. Once they grow a business, they allow the newly trained staff to take ownership and develop the operation as directors. They do this from their base in Brimscombe, where they operate a hub (providing space, facilities and support) that allows social ventures to grow and develop.

They found it easy to access SITR: they used Big Society Capital's guidance and they were able to use the BSC drafted documents which were immediately accepted by HMRC.

They received the permission around two years ago. The next stage was raising the money. The entrepreneur reached out to 4 close connections who were all willing to give £1675 each and they gave the Grace Network this money as a test to see that the process works. And it worked – they had to wait 6 months after the investment to submit the certificate to HMRC and they then confirmed it.

Recently the Grace Network successfully raised another £2,500 through SITR.

In the long-term Grace Network feels that if SITR continues, for them this is the most easily manageable loans, as they find it easier to convince local people to invest than big funders.

The Hub Yeovil is an UnLtd award winner social venture that helps people with learning disability and autism reach their full potential, lead active meaningful lives and to be happy. They specialise in building skills, fostering confidence and increasing emotional and economic well-being. They achieve these outcomes through six social enterprises that offer live work, skills training and where appropriate paid work. Their theory of change lies in the concept that being active and giving things a try leads to improved competence, communication confidence, citizenship and happiness.

The Hub Yeovil is aware of the SITR scheme but haven't had any success with it as they haven't found anyone in the position who would be interested in investing this way.

They wanted to increase their capacity and needed to secure a bigger property for this – and SITR was ineligible for this purpose. In their further investment-raising attempts through SITR they have encountered the following problems

- Many investors that knew the Enterprise Investment Scheme (EIS) still had no idea/ understanding of SITR.
- the Advanced Assurances required by investors were slow to be returned by HMRC and the delays led to them seeking alternative opportunities.
- It's an investment that requires lots of individual investors, which to many discerning investors is not how they like to invest.

For these reasons they were unable to benefit from SITR and have instead opted for securing investment from other sources.

Question 14

As an investor, enterprise or interested party, do you have a view as to why the take up of SITR has been less than expected?

We believe the premise and structure of SITR is a positive development for the sector. Our experience has revealed a number of factors that resulted in SITR having a lower take-up than expected, and we have highlighted our recommendations for the Government on how to unleash SITR's potential in bringing more capital into social ventures:

The challenge is in the supply, not demand side. The challenge is more in the supply of capital caused by uncertainty in investing in asset locked organisations. The added complexity of these models puts a number of investors off. More education on investing in asset locked organisations is therefore necessary.

Recommendations:

- ***Address the lack of investor awareness around Community Interest Companies (CIC) by investing in education and awareness-raising.*** Our anecdotal evidence suggests there remains a lack of knowledge from investors on CICs and other asset locked structures. There is uncertainty about their ability to sell assets, generate and distribute profit and potential for exits. The changes to the sale of shares and dividend distribution in 2014 went widely unnoticed.
- ***Open up SITR to mission-locked entities, not just asset locked ones.*** Our evidence suggests that that much of the demand for social investment lies within non-asset locked entities i.e. social purpose organisations. SITR should be about attracting new investors into this market but few can get over the hurdle of the restrictions around the traditional social enterprise model. In our experience very few funds can operate sustainably (even with the tax relief) if restricted to asset locked investments, and deal flow is so hard to come by. Please see more evidence on this in UnLtd's learning paper: https://www.unltd.org.uk/uploads/general_uploads/UnLtd-Spotlight-Purpose-Growth-impact-Digital.pdf

The copied model from EIS hasn't always been appropriate. Whereas the EIS tax relief has been effective in bringing capital into the sector, some of the restrictions placed upon it, which have been copied to SITR, have not necessarily been fit-for-purpose.

Recommendations:

Reconsider the £15m asset limit as it prevents asset rich but otherwise cash poor social ventures from accessing SITR. The £15m asset limit excludes some charities which are gifted and inherit buildings and other assets. Although they might be 'asset rich', they don't necessarily have the ability to extract any liquidity from these assets to invest in enhancing/providing service, particularly given the difficulty in selling these assets due to mission locks. As such the asset limit may prevent some organisations from accessing much needed capital enabled by SITR.

Remove the 30% maximum ownership restriction when investing in debt. Whereas the 30% maximum ownership makes sense for limiting control when investing in equity, that is not the case with debt (as investors are not buying shares). But the current restrictions mean one investor is not able to make a loan in full under SITR. Instead, they need to find co-investors to be eligible – this takes more time and effort which can even put off investors in some instances.

Question 15
Are you aware of any international examples of similar tax reliefs that have experienced greater take up than SITR?

We are not responding to this question as UnLtd does not look into similar tax reliefs internationally.

Question 16
How did you hear about SITR?

UnLtd has been aware of SITR from its very early stages.