Association of Charitable Foundations

Research briefing

Charitable trusts and foundations' engagement in the social investment market

Nikki Jeffery

Richard Jenkins

Representing charitable foundations and grant-making trusts in the UK

Acknowledgements

This research is the result of informed contributions from a wide number of people involved in trusts and foundations and social investment. As well as those ACF members who responded to our survey or took part in focus groups, we would especially like to thank the members of our Reference Panel for their advice and guidance: Claire Brown (Finance and Investment Director, Esmée Fairbairn Foundation); Jonathan Burchfield (Senior Partner Charity and Social Enterprise, Stone King; formerly Chair of Trustees, The Tubney Charitable Trust); James Money-Kyrle (Director of Support Services, St John's Hospital, Bath); Andrew Stafford (Director, Dulverton Trust); and Rob Williamson (Chief Executive, Community Foundation Tyne and Wear and Northumberland).

We extend our thanks to Jackie Turpin and Danyal Sattar for their help in running the focus groups and those others who generously agreed to give case study material: Leigh Pearce, James Perry and Paul Ramsbottom.

We would also like to acknowledge the contributions of the following who particularly helped with the formation of our findings: Leila Baker; Emily Bolton; James Brooke Turner; John Kingston; and Sara Llewellin. Additional thanks go to Katherine Duerden for data analysis.

About the authors

Nikki Jeffery has over 10 years' experience in the social sector, holding senior management and leadership roles in both UK and international charities. Until recently she was CEO of Target TB, an international health and development charity. Nikki is also a qualified accountant and has a particular interest in implementing best practice and innovations in financing social change. She has supported ACF with this research as part of her Clore Social Fellowship. Her website is **www.investingforsocialchange.co.uk**

Richard Jenkins is co-author of *For Good and Not for Keeps* and author of *The Governance and Financial Management of Endowed Charitable Foundations*, both published by ACF. He has been an independent researcher and consultant in the voluntary sector since 2008 and his current work includes being Policy Adviser to ACF.

The Association of Charitable Foundations

ACF is the membership association for foundations and grant-making charities in the UK. For nearly 25 years we have supported trusts and foundations; respecting and safeguarding their independence, and helping them to be effective in the many ways that they use their resources.

ACF has over 320 members. They range in size from large foundations with paid staff distributing over £20m a year each, to small often local volunteer-run trusts distributing less than £100,000 a year. Together though they give over £1.7b a year to a wide range of charitable causes. Across the UK, trusts and foundations provide about 5% of the total funding of the charitable and wider voluntary sector.

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Key findings

Foundations' engagement in the social investment market

Charitable foundations have played a significant role in building the UK social investment market over the last decade, providing an estimated £100m of risk capital, of which around £50m has already been committed to deals.

Ten foundations with endowments exceeding £100m, without permanent restriction and with staff, have provided nearly 90% of foundation investment. There are only about 20 such foundations in the UK.

A typical foundation investment so far is a direct investment of £100,000 for a term of about five years, usually in the form of a loan and often with some income return that depends on the success of the project.

Attitudes and behaviours around social investment

Foundations see social investment as one tool in the toolbox alongside other forms of support. They consider that in some but not all cases it can be as or even more effective than a grant, and that it can attract other complementary investment or support.

Foundations engaged in social investment frequently provide risk capital to charities and social enterprises that are starting or scaling up or that need working capital.

Although social investments typically can deliver below market returns and/or involve venture capital style risks, those who make them feel they are justified because of the social return.

Factors that affect foundations' engagement

Foundations, unless a specific social investment is anticipated to make a market equivalent financial return, are legally required to make social investments in line with their particular charitable objectives, which can be broad or narrow depending on the organisation.

Social investment generally involves a financial trade-off for endowed foundations, with the possibility of either a reduction in the value of a foundation's capital over time or less money being available as pure grant.

Foundations report that significant governance and staff time are needed to set up and manage social investments but that lack of deals is the biggest barrier to doing more.

Foundations value lawyers, specialist intermediaries and advisers when making social investments, but find peer support most helpful of all.

Implications for the market

Social investment will not be for all foundations. Even where funding supports activity that can generate surpluses, some foundations may decide that it is more effective or desirable to allow organisations themselves to retain the money.

Foundations have a particular role to play in investing in social purpose organisations at stages when they find it difficult to access commercial finance or which fall outside the service delivery mainstream.

Foundations have a rich history of supporting social good and their expertise in judging the likelihood of a social return being delivered is a unique contribution to the social investment market.

Introduction

This briefing, based on a survey of members of the Association of Charitable Foundations (ACF), is the first piece of research specifically focused on the behaviours, attitudes and interests of UK charitable foundations in relation to 'social investment'. In this report 'social investment' means investments that provide a social as well as a financial return, ranging from, for example, straightforward loans to performance-related bonds.

It aims to present the key points and implications of that research for policy-makers and those seeking to build the social investment market. It is not intended to be a guide to social investment for practitioners, but we hope that the information will be of interest to foundations themselves.

Foundations and the social investment market

Charitable foundations have played a significant role in providing risk capital for charities and social enterprises

The social investment market in the UK has grown from its infancy a decade ago to an annual investment in 2012 of over £200m in charities and social enterprises.[1] 90% of that investment is in the form of secured loans, with the balance being risk capital.

Charitable foundations have been an important part of the growth. Foundations such as the Esmée Fairbairn Foundation, the Barrow Cadbury Trust and the Tudor Trust were early backers of social investment pioneers like Charity Bank, CAF Venturesome and Bridges Ventures, and with others they have continued since to test and pilot the concept. More recently, increasing numbers of foundations have invested not just to grow the market but to deliver their programmatic aims.

Government too has sought to build the market, from the creation of the £125m Futurebuilders fund in 2003 to the launch in 2012 of Big Society Capital with £600m to invest over time. Despite that, charitable foundations are still an important potential source of funding for the growing market, particularly in relation to providing risk capital.

A survey carried out for this research recorded 23 foundations which were active in the market or who have already decided to enter it. Between them they had committed nearly £80m for social investment, of which they had already made

[1] *Growing the Social Investment Market: The Landscape and Economic Impact*, written by ICF GHK in association with BMG Research, 2013.

£47m in investments. We estimate that our sample makes up a large proportion of all of the UK foundations engaged in social investment, who probably number no more than 30. Further market intelligence suggests that in total trusts and foundations have allocated at least £100m to the social investment market, of which around £50m has been committed to specific deals.

The survey revealed that foundations' motivations for using social investment vary, but chiefly ACF members rate social investment as a useful tool alongside other forms of funding, support and activity to achieve their charitable objectives. Second, foundations valued the possibility social investment offers to collaborate with other funders. Third, they valued social investment as a means of recycling funding.

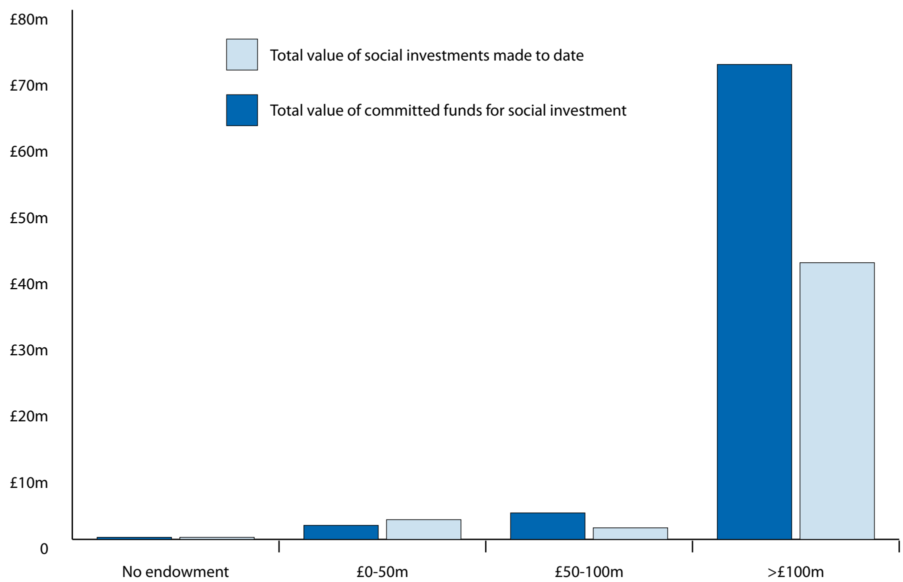
Large organisations provide most of the existing foundation social investment

Larger endowed foundations that are not permanently endowed and that have staff are those most likely to engage in social investment. Although some foundations without an endowment or with few staff are involved, 10 foundations with endowments exceeding £100m are responsible for nearly 90% of the social investments highlighted in our survey, with Esmée Fairbairn Foundation alone a clear market leader and builder, responsible for around 45% of the deals made.

The typical sort of foundation engagement to date is a direct investment of risk capital, made in the thematic area of an existing grant programme, most likely in the form of a loan (often unsecured), but perhaps with some element of income return linked to the success of the project. The average investment is worth £100,000. Most investors in Social Impact Bonds are larger foundations (those with endowments exceeding £50m). The average length of all investments is around five years, a typically longer time horizon than conventional investments or grants.

Such investments are reported as often being risky, frequently involving start-ups or investment in an organisation that has no track record of previously managing repayable finance, or where the organisation is using the capital to scale up to the next level or win a contract for public service delivery. Such investments are expected to return a lower rate of financial return than purely commercial venture capital deals involving equivalent risks. In focus group discussion, foundations were clear that they are prepared to make the investments because they feel that the social return generated justifies taking the risk and/or compensates for a lower financial return.

Foundations with larger endowments have provided the vast majority of foundations' social investment



The **Esmée Fairbairn Foundation** is one of the leading UK foundations involved in social investment. The Foundation has an endowment of £850m and every year spends around £32.5m on grants and £5m on social investments. As well as making a significant number of investments, the Foundation has developed a role in encouraging others, where appropriate, into the social investment space and in building market mechanisms and structures to enable non-charitable monies to be invested.

The Foundation had been making simple loans to grantees from as far back as 1997 in response to requests from those organisations. The decision to move more intentionally into social investment evolved organically from that, as trustees could see that more grantees would value this sort of financing. While the scale of the Foundation's social investment has increased significantly since then, including the creation of a dedicated small team specifically to deliver it, the intelligence and experience from its grant-making remains fundamental to informing decisions around social investment.

Opportunities and constraints for charitable foundations

Our research highlights the key importance of a foundation's mission to making social investment, with nearly every respondent reporting that they make social investments within the area of their existing grant programmes. Foundations from across the full range of charitable purposes are making social investments – the market is not focused on specific areas of benefit. Mission therefore provides focus. However, it can also be challenging if a foundation works within very narrow geographical or charitable areas.

Those who are already involved noted that at times significant governance and staff time are needed to get into the market and manage investments. Our findings reveal that charitable foundations with few if any staff are less likely to be involved in social investment, suggesting they may face some capacity issues in relation to getting into the market. ACF data shows that the majority of charitable foundations with endowments of up to £50m have no staff or operate with trustees supported by a single, sometimes part-time, employee.

Foundations with smaller endowments are also less likely to be involved, perhaps revealing an additional sense that they have less risk margin than foundations with more capital to deploy.

However, for those already in the market, by far the biggest barrier they face in getting more involved is a lack of appropriate deals in which they can invest.

Enablers for foundations to engage in social investment

Our findings paint a picture of a characteristically independent approach among foundations – with practitioners choosing to seek support from each other over and above specialist intermediaries.

The majority of foundations' social investments are direct (i.e. into a charity), often requiring much more intensive efforts than indirect investments (i.e. into a fund such as CAF Venturesome). Most foundations use the professional services of lawyers. While a good majority of participants in our research have used specialist intermediaries, half still feel that greater staff and trustee skills or time would make it easier to assess and monitor social investments. Discussions revealed that trustees can often be the initiators for their foundations getting involved in social investment.

Those who have yet to engage with social investment, if they haven't already ruled it out, are more likely than those already engaged to think that greater expertise among mainstream investment experts would make a difference.

Panahpur is a family foundation, established in 1907, to support vulnerable and excluded people through a range of social interventions. The foundation has a £6m endowment and has made around £2m of social investments to date.

In the early 2000s, the trustees identified a lack of sustainability in the way in which they were funding charities and felt their real need was for capital investment. They came to the conclusion that grants alone weren't going to help in the longer term and became interested in the potential of social investment. In tandem with this the trustees looked at how the foundation's capital was being managed, and by whom. They felt that they were using the foundation's capital on the conventional market in ways that contradicted the purpose for which investment returns were being used – that of empowering disadvantaged individuals.

Panahpur has since transitioned from a traditional grant-maker to a mission related investor. It invests its capital across a spectrum of investments, with grants at one end which, while not making a financial gain, build the sustainability of beneficiary organisations, through 'blended return' investments giving a financial and social return. At the other end are investments focused on maximising financial returns.

Issues for foundations in relation to social investment

Balancing social investment with other calls on capital

Participants in our research reported that social investment portfolios, so far, tend to produce risk-adjusted returns below that of conventional investments. While the recycling of funds for social investment in one sense means greater efficiency, from another perspective a below market return, unless it is balanced by other parts of an investment portfolio with perhaps higher risk, raises the possibility of either a reduction in the value of capital over time or less money being available as 'pure grant'.

Social investment therefore sits within a series of wider operational objectives that foundations frequently have to consider. If they have endowments, long-term foundations must strike a balance between:

- The capital they put to work year on year to generate funds to support their activity;
- The level of grant-funding and other support they want to make; and
- The level of social investment they feel it is appropriate to make in pursuit of their charitable objectives.

Foundations reported that frequently other market builders do not sufficiently understand such concerns.

Public service delivery

Collaboration across sectors is one of the benefits cited by foundations when they talk about their experience of using social investment. However, collaboration with the public sector raises issues that have a practical as well as a principled dimension. Participants in our research revealed that some foundations are willing to invest to help social purpose organisations break into the market and so achieve scale, and some are also willing to invest in the long term to help develop services. But we found that not all foundations may be so willing, particularly if they feel they fund on the principle of 'additionality' – meaning that generally they will fund only those things that the public sector does not.

The Wolfson Foundation, established in 1955, supports infrastructure and excellence in the fields of science and medicine, health and disability, education, and arts and humanities. It has an endowment of around £800m with no restrictions around permanence, and investments are made to maximise returns to fund charitable activities. The Foundation has an annual grant spend of around £35m.

The Foundation has carefully considered social investment but has chosen not to divert funds from supporting its grant programmes at the current time for a number of reasons, including the level of risk associated with social investments, together with the resource and expertise implications of doing social investment properly.

Paul Ramsbottom, Chief Executive says: *"Conversations with grantees have also highlighted that right now, the Foundation's philanthropic role in providing infrastructure funding is more important than ever. At the current time the Foundation does not want to shift to a relatively risky social investment model when our grantees suggest they need something else."*

The **Nationwide Foundation** is an independent foundation, funded by the Nationwide Building Society with an average annual grant spend of around £1m. The foundation does not have an endowment or other mainstream investments but has fully incorporated social investment into its latest strategy to support the provision of decent, affordable homes for people in need in the UK, offering funding applicants the possibility of applying for grants and/or social investments. For the Foundation, social investment is entirely about social return and it will consider applications for social investment alongside grant applications based on how well they fit with the funding strategy at the time.

The Foundation made its first social investment in 2009. Leigh Pearce, Foundation Manager, describes how lengthy discussions were required around the decision to go ahead with their first social investment: *"As a non-endowed foundation with no investment portfolio, the trustees considered our position with regard to social investment very carefully and it took some time to find an approach that we were comfortable with to differentiate social from financial investment. We use social investment as one of the tools available to us to achieve our charitable objects and assess opportunities for social investment in almost the same way as we assess grant applications, but with some additional considerations around risks and return."*

So, as well as helping organisations achieve scale, we predict that some foundations are likely to be as interested in developing services that fall outside those that are likely to attract state or commercial investment, or in supporting innovation.

Social investment is one among a range of tools foundations use

All the foundations that took part in this research use social investment as one tool among others to achieve their objectives. They do so because they judge that, in some but not all instances, social investment is more effective than giving a grant – because the organisation prefers investment to develop or scale up operations on an enterprise model, because it needs working capital, or, from a foundation perspective, because the money can be recycled. Notably, a quarter of the foundations who in the survey stated they had not made social investments nonetheless indicated that they had in the past made a loan, a recoverable grant, or a grant to enable an organisation to take external investment. None of our participants feel that social investment could or should replace all grant funding, although some talked about offering a mix of support to the same organisation. With public sector grant-giving diminishing as a result of cuts and the greater use of contracts, many of the foundations we spoke to are aware that they are increasingly becoming one of the few sources of grant finance.

Implications for those building the social investment market

These findings suggest a number of factors to be considered for those who wish to encourage foundations into the social investment space.

Social investment must match a foundation's mission

Our findings suggest that those who are seeking to increase the flow of foundation capital to the social investment market should have a realistic understanding of the constraints on foundations. First and foremost, unless the investment can be justified on financial grounds alone, foundations will need social investments to match their particular mission.

Social investment is not a zero sum transaction

Foundation endowments don't lie dormant but are invested to provide revenue for grant funding and other forms of non-profit-making charitable activity. This requirement needs to be taken into account by endowed foundations when deciding how much to socially invest, given that most participants expect their social investments taken together to make a below market, risk-adjusted, rate of return.

A high proportion of the most accessible foundation capital may be committed already

Our research suggests that approximately a half of those foundations most likely to get involved in social investment are already engaged in the market – i.e. larger, non-permanently endowed foundations with staff. As some of these foundations, like The Wolfson Foundation, may decide that social investment is not for them, it could be that that the 'low-hanging fruit' of capital from such foundations could quickly become used, especially given the relative illiquidity of many social investments.

Social investment will not be for all foundations

It is important to bear in mind that the greater number of foundations in our survey are not yet engaged in social investment. While interest is increasing, some trusts and foundations are questioning whether social investment is right for them. For example, some wonder whether the act of investing fundamentally shifts the relationship between funder and organisation to a transactional model that diminishes some aspects of the partnership. And others have questioned, if a charity or social enterprise is capable of generating surpluses, 'who will be most effective at recycling the funds created by the investment? The investor or the investee?'[2] Some foundations may therefore decide not to socially invest even where funding can help generate a return.

Foundations can provide crucial injections of risk capital

However, it seems that those foundations who are socially investing, even in relatively small sums, are frequently providing genuine risk capital for social ventures at stages where they may find it very difficult or impossible to attract commercial investment or secured debt. This suggests that foundations have a potentially important role to play in the funding ecology for social purpose organisations, being able to provide a unique mixture of grant, development and working

[2] Rotheroe, A., and others, *Best to Invest,* New Philanthropy Capital, 2013, London. p31.

The **Joseph Rowntree Charitable Trust** has an endowment of £170m and an annual grant spend of around £6m. In recent years the Trust has committed £2m to social enterprises, motivated by a concern to find better economic models for society and the economy following the financial crisis. The Trust is attracted to social investment because of the possibility of generating both financial and social returns, and sees it as a useful tool for supporting grantees. Most of the Trust's social investments have been fairly risky, start-up phase and were chosen for being most closely aligned to its mission.

Jackie Turpin, Head of Finance at the Trust, shares how its experience has highlighted the resource intensity and expertise needed to manage social investments: "*The amount of time spent managing our social investments has been considerable and has required the development of new skills and expertise. We've also found that business expertise within social enterprises taking on investment is critically important, and has proven to be an important factor when we've reviewed the performance of our investments.*"

capital. Trust and foundation investment can also help attract other investors and their capital into social purpose organisations.

Foundations need various market mechanisms to support their engagement

The need for foundations to take an independent path may explain why peer-to-peer support is the most highly rated form of help from current investors. On the other hand – given the degree to which internal capacity appears to be an issue for foundation investors – market intermediaries and other advisers and managers are likely to provide a boon to foundations and the market if they can place themselves in the position of the individual foundation and its mission. This suggests that access to information and support is an important factor not only in helping foundations to make their first steps, but also in ongoing management.

As deal flow is an issue, mechanisms seeking to match foundations and investment opportunities must allow them easily to link their concerns with opportunities where there is a transparent and clearly articulated social benefit. Looking further ahead, social investment may only become truly possible for many foundations when mainstream investment managers develop expertise and agility in the area, or when specialist intermediaries improve their reach and offer.

Creating liquidity is a key factor in freeing up investment

Given the relatively illiquid nature of most investments made to date (i.e. the investment capital will not be returned until the end of the deal), attempts to create a secondary market will help make recycling a reality as well as enable more foundation investors to become involved. Otherwise there is a risk that the most readily available foundation funding could quickly become invested and effectively out of reach for some years.

Foundations have more to offer than just funding

Finally, as long-time backers of social good, foundations have expertise in judging the likely success of a particular idea or intervention. Their experience, gained, for example, through grant programmes, means that they have access to a rich layer of know-how, expertise and networks that can help other investors understand which investments are more likely to yield a social return. Like good financial investment, knowing which social entrepreneurs and organisations to back is an art as well as a science, and it requires intuition and on-the-ground knowledge as well as objective analysis. If the market can develop in ways that facilitate rather than inhibit foundations' involvement, everyone is likely to gain.

Research analysis

Introduction

During early summer 2013 ACF carried out research with its membership. The aim was to understand the emerging social investment market from the view of charitable foundations. For the purposes of the research, 'social investment' was defined as an investment that provides a social as well as a financial return. Gathering of members' views included an online survey, two focus group discussions, and key-informant interviews.

The foundation sector

Analysis of Charity Commission data by ACF carried out in 2012 revealed that there are 63,000 charities in England and Wales that make grants to organisations or individuals as part of their activity. There are estimated to be about 12,000 grant-making foundations in the UK.

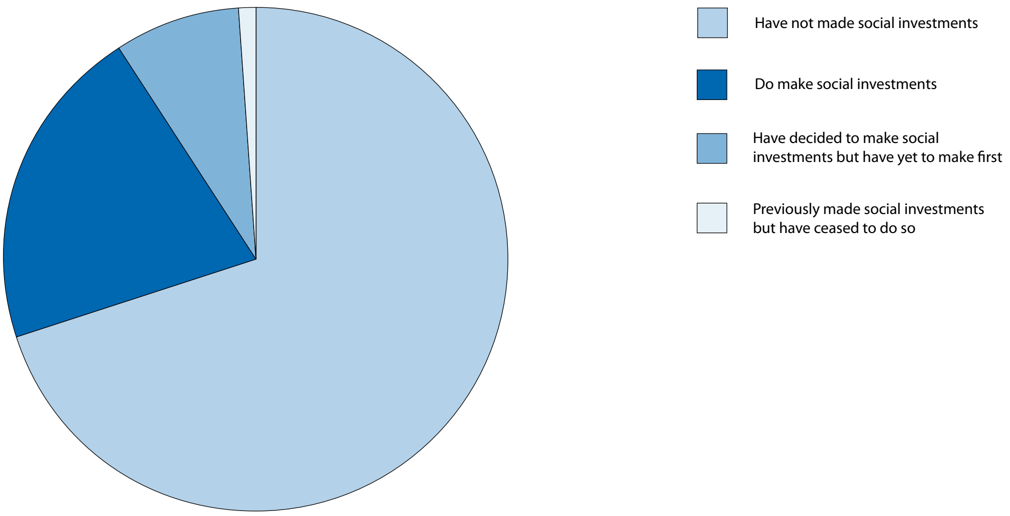
There are 900 endowed charitable foundations in England and Wales with annual income exceeding £500,000. These 900 make up one per cent of all registered charities; their combined assets amount to £48.5bn and account for over half of the charity sector's total assets.[3]

Participants' engagement in social investment

Out of a total 320 charitable foundations invited to respond to the survey, 84 replied. 70% of foundations responding to the survey indicated that they had not made social investments.

[3] See, Jenkins, R., *The Governance and Financial Management of Endowed Charitable Foundations*, ACF, 2012, London, p12.

Participants' engagement in social investments



The scale of foundations' participation in social investment

17 foundations responding to our survey have already made social investments, and a further six have decided to engage in social investment but have yet to make their first investment. ACF's own market intelligence suggests that there are no more than 30 foundations in the UK engaged in social investment.

The total aggregate committed for social investment, based on our survey responses, is just over £78m, of which just under £47m has been made by foundations so far. We estimate to date, based on ACF market intelligence, that a total of around £100m risk capital has so far been invested in the UK social investment market by trusts and foundations, of which approximately £50m has been committed to deals.[4]

Among foundations who responded to our survey, only three have made more than 10 investments, one of whom, the Esmée Fairbairn Foundation, has made 65 individual investments – representing 44% of the total number of investments directly captured in our research.

Among respondents, the size of individual investments ranges from just £1,000 to £1.75m. The size of the average individual social investment is just over £100,000.

Why might foundations want to use social investment?

Survey participants rate social investment, in order, as:

- A useful tool alongside other forms of funding, support and activity that they used to achieve their charitable objectives;
- An opportunity to collaborate with other funders;
- A means of recycling funding;
- An innovative way to achieve their mission; and
- A more appropriate form of funding than grants for the organisations in which they had made social investments.

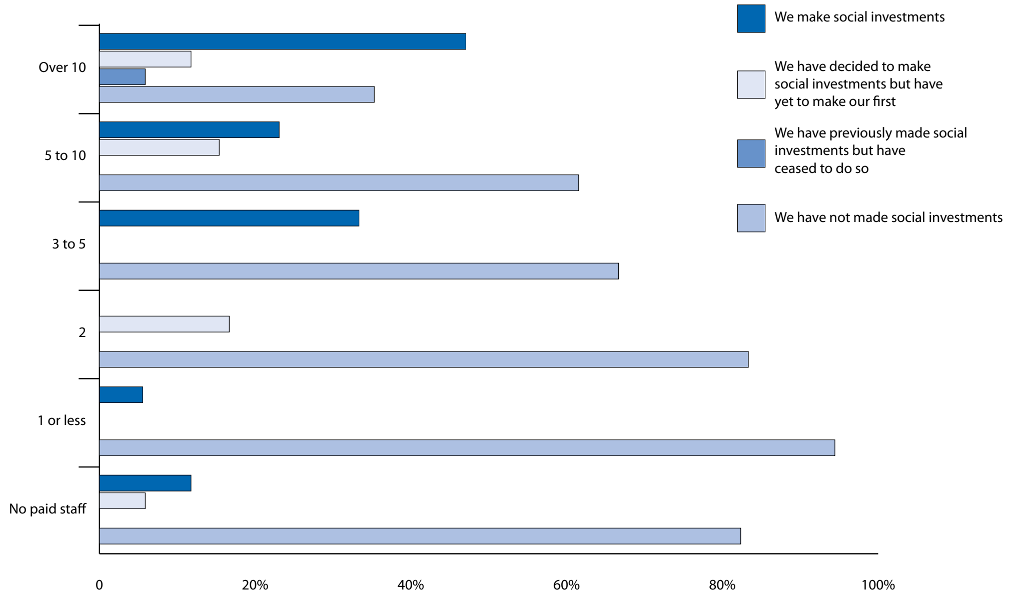
A view expressed in focus groups is that social investment could be one of a range of ways which together have the potential to help foundations get the most from all their resources. Some foundation participants described further benefits of using social investment as being increased knowledge and engagement with the organisation they are investing in.

These motivations echo findings from a recent IVAR study. By contrast, the same research found that market intermediaries tend to think the main motivation for using social investment is the possibility of achieving scale and replication.[5]

[4] Our survey asked respondents to indicate how much they had committed for social investment, even if they had not invested the entire amount. It also asked them to indicate the total amount of funding they had made as social investment. We calculated our totals by adding the mid-points of the ranges indicated by respondents, specific amounts where they gave them or (where they had identified themselves) amounts that we were otherwise able to verify. Our market intelligence is based on additional published or sourced information on foundations not included in our survey responses.

[5] *Charities and social investment: A research report for the Charity Commission*, Institute for Voluntary Action Research, 2013, London, p24.

Relationship between number of staff and engagement in social investment



What sort of foundations are more likely to engage in social investment?

Our survey reveals that 15 of the 17 foundations that have made social investments have endowments. The most common type of social investors are those with endowments in excess of £100m that are not restricted in terms of permanence, and who have larger teams of staff.

Ten of our survey respondents have endowments exceeding £100m. Taken together these 10 foundations are responsible for nearly 90% of the total social investments made by foundations so far.

We found no correlation between the sort of charitable objectives that a foundation has, its age or any geographical focus, and the likelihood of it making social investment.

What sort of foundations are less likely to engage in social investment?

By contrast, organisations with smaller endowments or those who are restricted to supporting only registered charities are less likely to make social investments. Of the 54 foundation respondents who have not made social investments, nine have endowments that are mostly, if not entirely, (i.e. more than 75%) permanently restricted – a greater proportion than those who do make social investments.

Staff capacity is an important enabler for engagement in social investment. The more staff a foundation has, the more likely it is to make social investments. Among respondents who haven't made social investments, 31 of the 54 have one, or less than one, full time equivalent member of staff. In addition, organisations without staff are more likely to report that 'social investment does not meet their charitable objectives'.

ACF analysis carried out to support this research identifies 31 grant-making endowed charities with assets of greater than £100m that directly employ staff.[6] As generally a third of foundations have permanent restrictions,[7] we estimate therefore that there are only around 20 foundations that match the profile of the most common and most significant current social investors.

What sort of social investments are foundations making?

Loans are by far the most common form of social investment made by foundations (over 80% of respondents). Quasi-equity or revenue participation is the next most popular, having been made by just over 40% of respondents who have already made a social investment.

The majority of focus group participants who have engaged in social investment have made direct investments. Five of the 16 survey respondents who gave details of the social investments they had made had invested in Social Impact Bonds, and three had invested in third-party funds such as Big Issue Invest or CAF Venturesome. All those investing in Social Impact Bonds or third-party funds have endowments exceeding £50m.

37% of investments are expected to run for two to five years and 25% for between five and 10 years. The average investment term is around five years.

Notably, of the 54 foundation respondents who indicated they had not made social investments, 13 of them also indicated that they have in the past made a loan, a recoverable grant, or a grant to enable an organisation to take external investment.

What are the constraints on foundations in relation to social investment?

Mission: Mission is the biggest factor determining what foundations will invest in. Over 75% of those who have already made, or have decided to make, social investment did so in the area of their existing programmes. Only one respondent has made a social investment that falls outside the area of their existing grant programmes. One survey respondent noted:

> *Most of the social investment opportunities [we receive] are not from organisations we would support with grants so the match with our 'mission' is poor.*

The opinion was expressed in key informant interviews and focus group discussions that other market participants don't fully appreciate that foundations' assets can only be used to support their specific charitable objectives. A foundation's choice then of whether to use social investment is likely to be determined by the degree to which the investment would help it deliver its mission.

> *The main driver for social investment must be whether it is the most effective way in which a foundation can achieve the social change they are looking for – ultimately each foundation must make this decision for themselves, independently. (Focus group participant, London)*

[6] Grant-making endowed charities were identified through analysis of a data set of charities on the Charity Commission for England and Wales' Register of Charities (as at October 2011) that in their latest Annual Return had indicated that they make grants to organisations or individuals, or both. There are a total of 49 charities that are endowed (total resources expended was 10% or less of their total assets), have assets exceeding £100m and directly employ staff. For 18 of these charities, grant-making is a minor function (grant expenditure represents less than 40% of total expenditure).

[7] Jenkins, R., Rogers, K., *For Good and Not For Keeps, How long-term charity investors approach spending on their charitable aims*, ACF, 2013, London, p33.

Risk: Research participants spoke about the often high levels of risk associated with social investments. They frequently find themselves making investments, for example: in organisations that have no track record of previously managing repayable finance; where the enterprise is a start-up; where an existing organisation is seeking to scale up to the next level; or where repayment depends on winning contracts for public service delivery. Generally, for those who engage in social investment, it is felt that the social return justifies such risk-taking.

When it comes to making judgments about risk, focus group participants generally feel that in relation to predicting whether the social return would be delivered, foundations were in a strong position by virtue of the experience they possess from running programmes.

> *We need to give a message to the market that UK foundations know a lot about community care in the UK – how it works and the models that underpin it. Some of us (foundations) have been doing it for a very long time and we can bring all of that expertise to the social investment market. (Focus group participant, York)*

However, there is less confidence that foundation staff, when making direct investments, have the skills to evaluate the risk, return and due diligence processes '*to see if the numbers stack up*'.

Rates of financial return of social investments: None of the survey respondents who have or intend to make social investments expect to make an above market rate of financial return on their investment. Most investments are in the equivalent of SMEs, but are expected to return a lower rate of financial return than venture capital investments involving equivalent risks. Nearly 60% of such respondents expect below market financial returns on their social investments and the remainder think that their investments will return a mixture of above and below market rates. One participant observed that:

> *We expect the majority of our social investments, and our portfolio as a whole, to deliver below market returns in both absolute terms and on a risk-adjusted basis. Our portfolio does include a small number of investments that we expect to deliver a reasonable absolute financial return, however, we do not expect any of these to return a market rate of return on a risk-adjusted basis due to the risky start-up or innovative nature of the investments and their illiquidity.*

In focus group discussions participants noted the lack of reliable pricing of social investments, so that judgments about expected rates of return have to be made on a case-by-case basis. In connection with this, one survey participant wrote:

> *Our trustees feel that there is still no track record for the returns on social investment and also feel that until such time as it can be demonstrated that the returns on such investment outweigh the endowment income foregone, then it is better to have the income to spend on charitable activity.*

Deal flow: Practically speaking, among those already engaged in social investment, the biggest limitation to becoming further involved is a lack of suitable opportunities for investment. Three out of the four foundations that have already engaged in social investments but no longer do so cite a lack of suitable deals as their main reason for stopping. One focus group participant observed: *"There aren't that many deals. We all crawl over the same investments."* However, another participant believes that the lack of demand experienced by foundations is in part due to organisations in need of working capital not considering foundations as a source of investment.

> *My guess is that many organisations would never think of approaching a foundation to meet that shortfall... If people knew that they could approach foundations for this sort of funding, there could be a greater demand.*
> *(Focus group participant, York)*

Internal resources and costs: Participants who are already engaged in social investment also noted that it requires significant internal resources to manage in terms of trustee and staff time and expertise. When making social investments, organisations that previously haven't had such expertise find themselves having to develop the skills needed to make and manage loans and other forms of repayable finance.

What kind of support do foundations use when making social investments, and what would make it easier?

Nearly 80% of those who have already made or intend to make social investments rely on collaboration with other foundations as external support in making their investments. 40% cite a peer support network as a source of help. In terms of professional support, nearly 75% use lawyers and nearly 60% use specialist social investment intermediaries.

When it comes to thinking about what would make social investment easier, aside from a flow of more suitable deals, 50% of those who are already engaged in social investment indicate that greater internal capacity in terms of staff and trustee skills and time would help, followed by collaboration with other foundations or membership of a peer support network. However, fewer than 25% of them think that increased expertise in social investment from mainstream investment managers would make a difference.

In contrast, 33% of those who have not yet decided to engage in social investment think that greater expertise from mainstream advisers would help, with other forms of support being valued by only around 20%.

Cover photos courtesy of Barrow Cadbury Trust and Esmée Fairbairn Foundation.

ISBN 978-1-897916-36-0

This research briefing is published by the Association of Charitable Foundations (ACF), Central House, 14 Upper Woburn Place, London WC1H 0AE. Telephone: 020 7255 4499. Email: acf@acf.org.uk. Website: www.acf.org.uk

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