

What is social impact investment?

What it is, what it's not and how it works.


worthington

 **BUSINESS
IS
GREAT**
BRITAIN

Foreword



Sir Ronald Cohen
Chair, Social Impact Investment
Taskforce, established by the G8

I have been fortunate to play a role in two revolutions. The first, which was brought about by entrepreneurship, has transformed the way we live since I first started out to become a venture capitalist in 1972. The second, which we are on the brink of, is changing the way we finance and deliver social care through social impact investing. It is harnessing entrepreneurship, innovation and capital to power social progress.

The time has never been riper for a revolution of this kind. The crash of 2008 highlighted the need for financial institutions to be a force for stability rather than instability, and to play a role in building healthier societies. In short, to focus on risk, return and impact, rather than simply risk and return. At the same time, governments have come to realise that if societies' issues are to be tackled effectively, then more resources, skills and capacity are needed. Across the globe, governments are starting to build the eco-systems that will allow the impact investing movement to gather significant momentum.

The UK has been a world leader in this field. In 2013, during its presidency of the G8, the UK established the Social Impact Investment Taskforce. As its Chair, I witnessed the formation of a network of social investment leaders across participating countries. The upshot of our efforts was the publication of a series of country-specific reports in September 2014, which identified the opportunities and challenges of developing impact investment markets in participating countries. Today, National Advisory Boards in these countries continue to drive the agenda forward. Just as importantly, the legacy of the Taskforce will be a credible global forum where social impact investment can be discussed and ways of boosting it can be developed, across governments, business and social impact organisations.

I am proud to see that the UK continues to lead the way in social impact investing. As a global hub of impact investing efforts, it co-ordinates and champions the agenda across G7 countries. The UK has set up Big Society Capital (BSC), the first ever social investment wholesaler and market-builder of its kind. BSC is funding and supporting the creation of numerous impact investment firms. The UK also now has on offer tax incentives to boost a broad range of impact investment products, including secured and unsecured debt, quasi-equity and equity, and, importantly, social impact bonds (SIBs) which are being supported at the highest levels of government. Track-records for returns are being established across a growing range of impact investment products, laying the basis for attracting significant investment in the future. In short, investing in creating social impact in the UK now offers an exciting opportunity to do well and do good at the same time.

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A brief introduction

If you are reading this document you are likely to be in the majority of people who would like to see at least some of their investments focused on producing a positive outcome in society as well as a positive financial return. Social impact investment is turning this ambition into a reality for many.

This document is designed to guide you through the fast-changing landscape of the social impact investment market.

The UK picture

The UK is home to a great social economy, made up of thriving social ventures and the world's most advanced social impact investment market.

Social problems from health and ageing to homelessness and unemployment affect every country around the world. Britain is leading the way in developing innovative and sustainable answers to these challenges. From leading socially minded companies, which make up close to 1 in 5 businesses, to the most attractive environment in the world for social impact investors, Britain is at the heart of achieving social impact at scale.

Social impact investment uses private capital to generate social as well as financial returns. The UK is now the global hub for social impact investment. We have one of the world's most evolved social economies, and draw on Britain's expertise as a centre for international capital. Together, this makes for a unique marketplace for investors and enterprises alike, with:

- Increasing flows of capital - supported by the world's **first social investment bank in Big Society Capital**, which will provide £600m into the UK market, alongside leading business support schemes
- The most **advanced professional services** firms - with specialist legal, accountancy and banking services, and the most complete network of financial intermediaries anywhere in the world
- Unprecedented support from government - to ensure an effective regulatory and tax environment. This includes the world's first **tax relief for social investment**, and the UK placing social investment on the G8 agenda
- A diverse range of **investment opportunities** - drawing in the full range from retail to institutional investors. UK financial innovations include the first charity bond, social impact bond and the first mainstream Social Stock Exchange.

Internationally, investors are looking to UK firms to structure and manage their impact investment deals; and businesses and entrepreneurs are setting up in Britain to take advantage of the social impact investment on offer.

This document is designed to guide you through the fast-changing landscape of social impact investment, explaining the theory behind it and its practical implications. We will do this by looking at the objectives of social impact investment, the structure of the UK market and what sets this way of investing apart. We will give some case studies, aiming to provide you with a working knowledge of this new and growing financial market.

Defining social impact investment

✓ Social impact investment is...

- focusing on economic value alongside social dividends
- aiming to see financial returns for the investor
- tracking and reporting social outcomes
- compounding positive social effect by recycling original capital
- motivated by engagement with social causes

✗ Social impact investment is not...

- philanthropy—which expects no financial return
- socially responsible investment (SRI)—where negative investments are avoided but positive impacts are not always targeted

Thinking outside the pot

An important part of defining social impact investment (SII) is viewing it as a unique and separate method of investing, as opposed to a hybrid of traditional investment and philanthropy. This requires a shift in mindset from a traditional understanding of two wealth pots (one for philanthropy, the other for financial return) to the concept of three wealth pots, with social impact investment as a specific wealth deployment strategy.

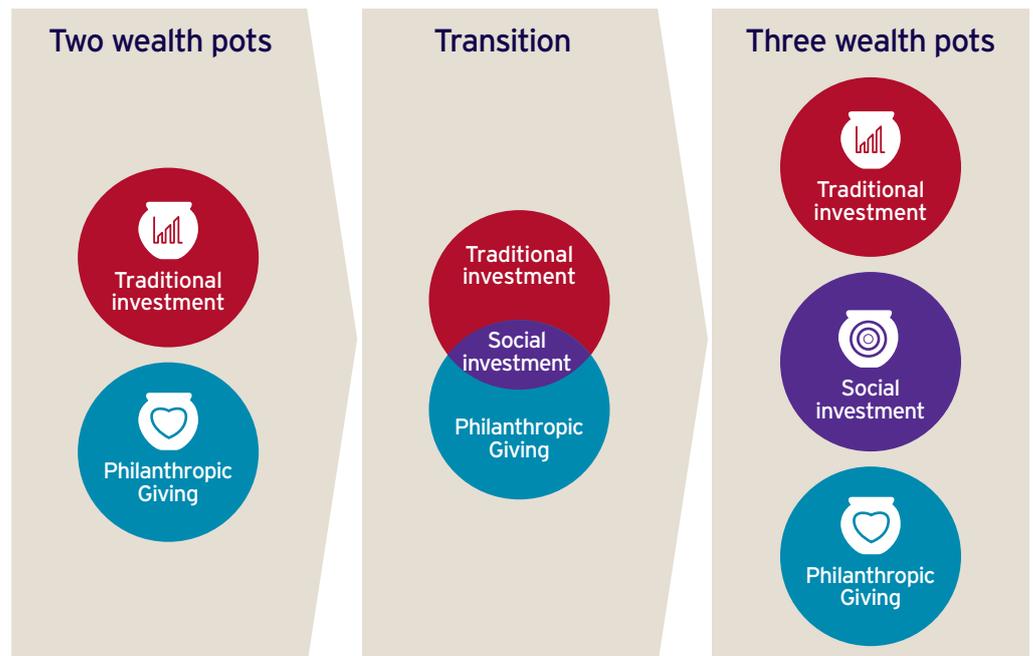
Primary motivations	Traditional investment	Social impact investment	Giving and philanthropy
Financial return	✓	✓	✗
Social return	✗	✓	✓
Capital to recycle	✓	✓	✗

Transforming a mindset

Traditional understanding of finance dictates that money can be used in two different ways: firstly as investment, where financial return is the priority and secondly as philanthropy, where social good is paramount and no return is expected.

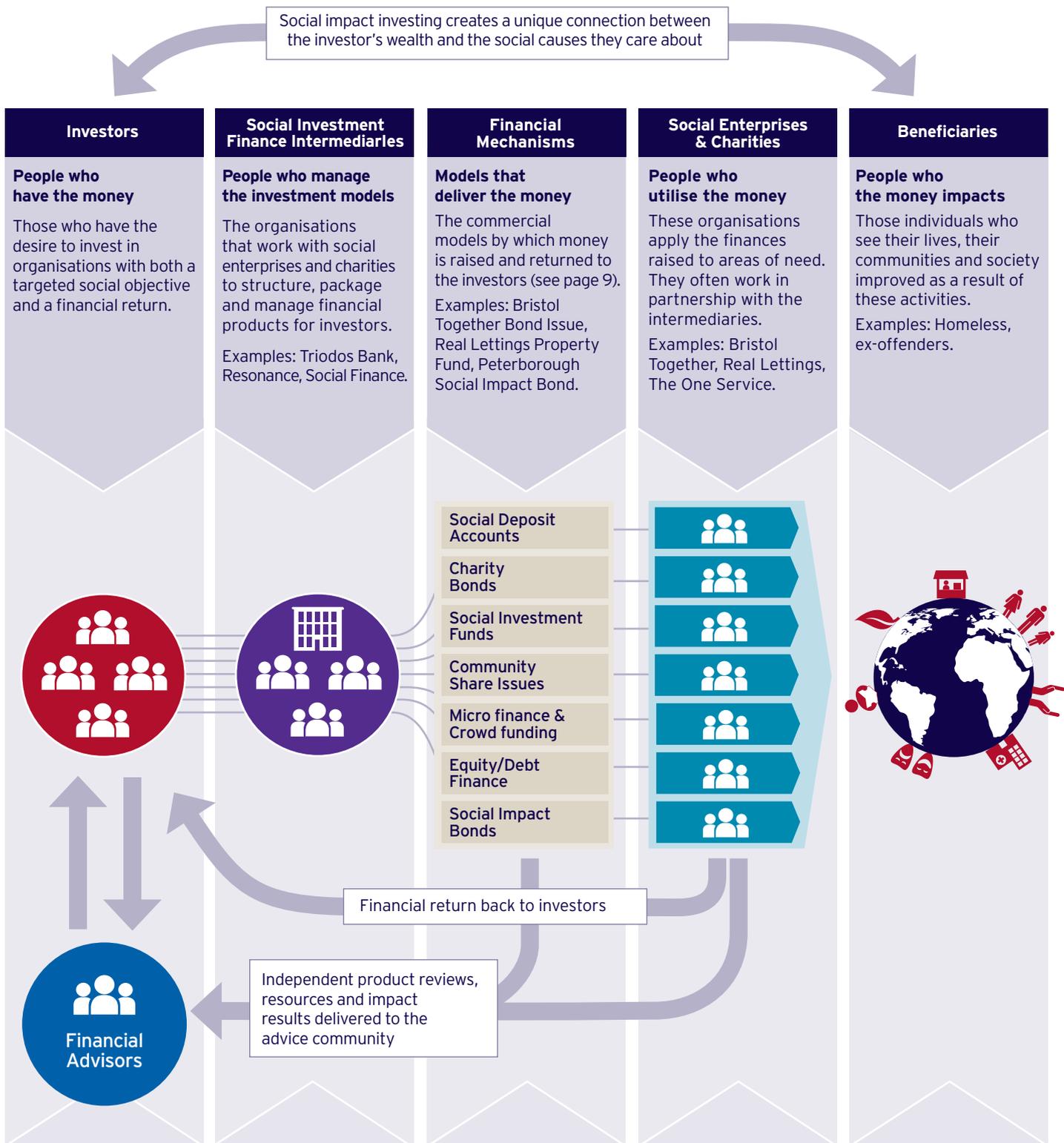
Many initially understand SII as a crossover between these two traditional methods but, while SII shares features with both, it is in fact a separate strategy, combining social good with financial returns to maximise the positive effect of an investment portfolio. A knowledge of SII and its objectives aids the understanding of SII as a 'new wealth pot'.

Whilst SII shares features with both traditional investing and philanthropy, it is in fact a separate strategy.



The social impact investment landscape

This diagram demonstrates the different features of the social impact investment landscape and the people involved. It illustrates the flow of finance through component parts to reach its target of positive social outcome.



What are the objectives of social impact investment (SII)?

Example

Golden Lane Housing (GLH) 2013 4% Bond.

This bond issue raised £10 million from investors for GLH (the lettings arm of Mencap) to buy and adapt 30 high quality homes for at least 80 people with learning difficulties. The bond pays 4% annually with the principal returned at the end of the 5 year term.

The returns in this case mean:

 Investors see a return on their principal capital and additional income because of rents paid by tenants.

 People with severe learning difficulties are provided with affordable and habitable homes, the tenants' quality of life is greatly improved because of GLH's social mission, which is to give tenants a high degree of control over their living arrangements.

SII has several aspects that help to differentiate it from other forms of investment. This section is intended to frame an understanding of SII.

Social impact investment...



Provides a return on capital



Solves a social problem



Provides accountability between investor and enterprise



Tracks and reports social impact



Provides opportunities to recycle profits for purpose

Provides a return on capital



Wealth creation, alongside social benefit, is central to social impact investment.

Investees aim to repay investors. Payments can be in the form of:

- the return of the initial capital investment (the investment 'principal')
- additional income over and above the original capital amount ('additional return') which can be in the form of interest, dividend or internal rate of return (principally dependent upon the instrument used for the investment).

Returns will vary depending on the investment type, term, and risk much like traditional investment (see left for example).

Solves a social problem



SII is about actively solving specific social needs.

It does this sustainably, measurably and definitively.

- Sustainably, by aiming to provide a financial return which facilitates further and increasing investment
- Measurably, by aiming to provide tangible results on investment
- Definitively, by placing social impact at the core of both its measure of success and its business model.

Social Impact Investment provides the initial capital on which social enterprises can scale their commercial model and social mission (see left for example).

Provides accountability between investor and enterprise



Because SII is an investment, a business-like culture between investor and enterprise prevails; responsibility to return capital creates accountability and necessitates a commercial approach.

The discipline required in this investment relationship helps retain focus on positive social outcomes, encouraging:

- good stewardship of resources
- clarification of financial and social objectives
- effective and efficient management of the social organisation.

The key feature here is that the two-way relationship between investor and investee means the investor remains involved beyond the initial capital payment, and as such the enterprise is more accountable to the investor.

“...success is measured along every step of this journey, from the moment the investment benefits society to the moment the capital is returned.”

Tracks and reports social impact



A defining aspect of this type of investment is its measurable social impact.

The investee is obliged to monitor, report and provide evidence for the impact of an investment, including its:

- products and services (output) resulting from an organisation's activities
- the short-term changes and benefits (outcomes)
- the resulting long-term effects (impact).

Impact reporting is key to understanding the success of SII. As such, goals are measured along each step of this journey, from the moment the investment benefits society to the moment the capital is returned.

Defining and measuring impact encourages effectiveness and focuses investee companies on the delivery of the key objectives of their social missions. For the investor, information about their capital and its positive impact reinforces the connection between their wealth and their social goals.

Provides opportunities to re-invest profits for purpose



Social enterprises operate a commercial model, which means they can return capital to investors. The continuing ability to reinvest the money leverages the good effect.

Social enterprises create social good through commercial means, therefore SII is essential to their funding and expansion, offering a financially sustainable way to:

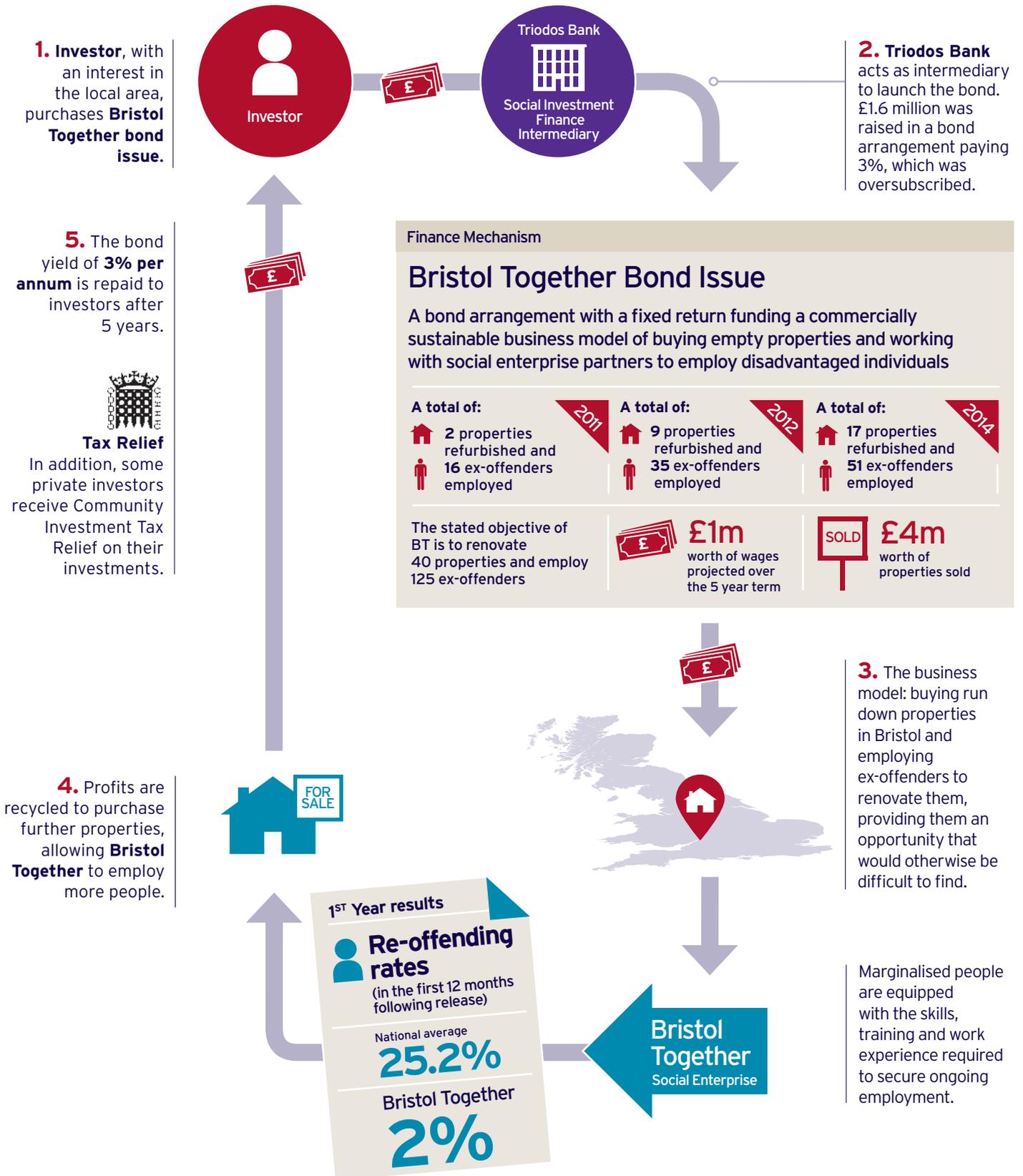
- grow commercially
- grow their impact

This creates sustainable commercial models lasting beyond the term of the capital investment. Return of the principal and additional capital invested ensures an ability to use the money for further social good.

The journey of the money/Case study 1

Bristol Together (BT)

Provision of training and employment for ex-offenders through property renovation.



Financial mechanisms

Social investment capital can be deployed in a variety of ways, which are outlined below. These financial mechanisms are the means by which money is received from and returned to the investor.

Financial mechanism	Examples
<p>Social Deposit Account Funds deposited are used to lend to charities, social enterprises and community organisations to help them meet their objectives. Investors earn interest on these accounts.</p>	<p>Charity Bank Unity Trust Bank Triodos Bank</p>
<p>Charity Bond A charity bond is a way of debt financing social enterprises or charities. These organisations then repay the investor with interest as an income during the investment term and return their original investment.</p>	<p>Scope Bond Wellcome Trust Golden Lane Housing</p>
<p>Social Investment Fund A ready-to-deploy pool of capital available to charities or social enterprises through a professionally managed, diversified fund.</p>	<p>Big Issue Invest Impact Ventures UK Real Lettings Property Fund</p>
<p>Community Share Issue A way of financing community orientated projects by buying equity in them. Any proceeds from this project are recycled back into the community as well as to the investors.</p>	<p>FC United of Manchester Exeter Real Food Store Dingwall Wind Cooperative</p>
<p>Crowd funding/microfinance A way of using smaller sums of money to fund businesses. Crowd funding allows organisations to receive investments from a large number of individuals, often directly. Similarly, microfinance allows individuals to take out small low interest loans.</p>	<p>Spacehive Kiva Buzzbank</p>
<p>Equity Investment/Debt finance Investors provide risk capital focused on socially motivated companies that can employ repayable capital and deliver a return to investors. Equity investors also have a control of the social enterprise and can expect dividends from profits.</p>	<p>Bristol Together bond issue Individual private equity deals</p>
<p>Social Impact Bond (SIB) A structure where an investor funds a service provider to deliver a specified social outcome which a public body has commissioned and contracts to pay for based on the achievement of pre-determined results criteria.</p>	<p>Peterborough SIB Think Forward SIB Essex SIB</p>

Individuals investing into qualifying organisations are able to offset 30% of the amount invested from their income tax bill - and growth in value is CGT-free



Social Investment Tax Relief (SITR) is a government initiative to encourage investors to invest in qualifying social enterprises through newly issued shares or unsecured debt investments. Individuals can invest up to £1 million per annum in more than one social enterprise (independent of any investments under other tax reliefs) and investments must be held for a minimum of three years.

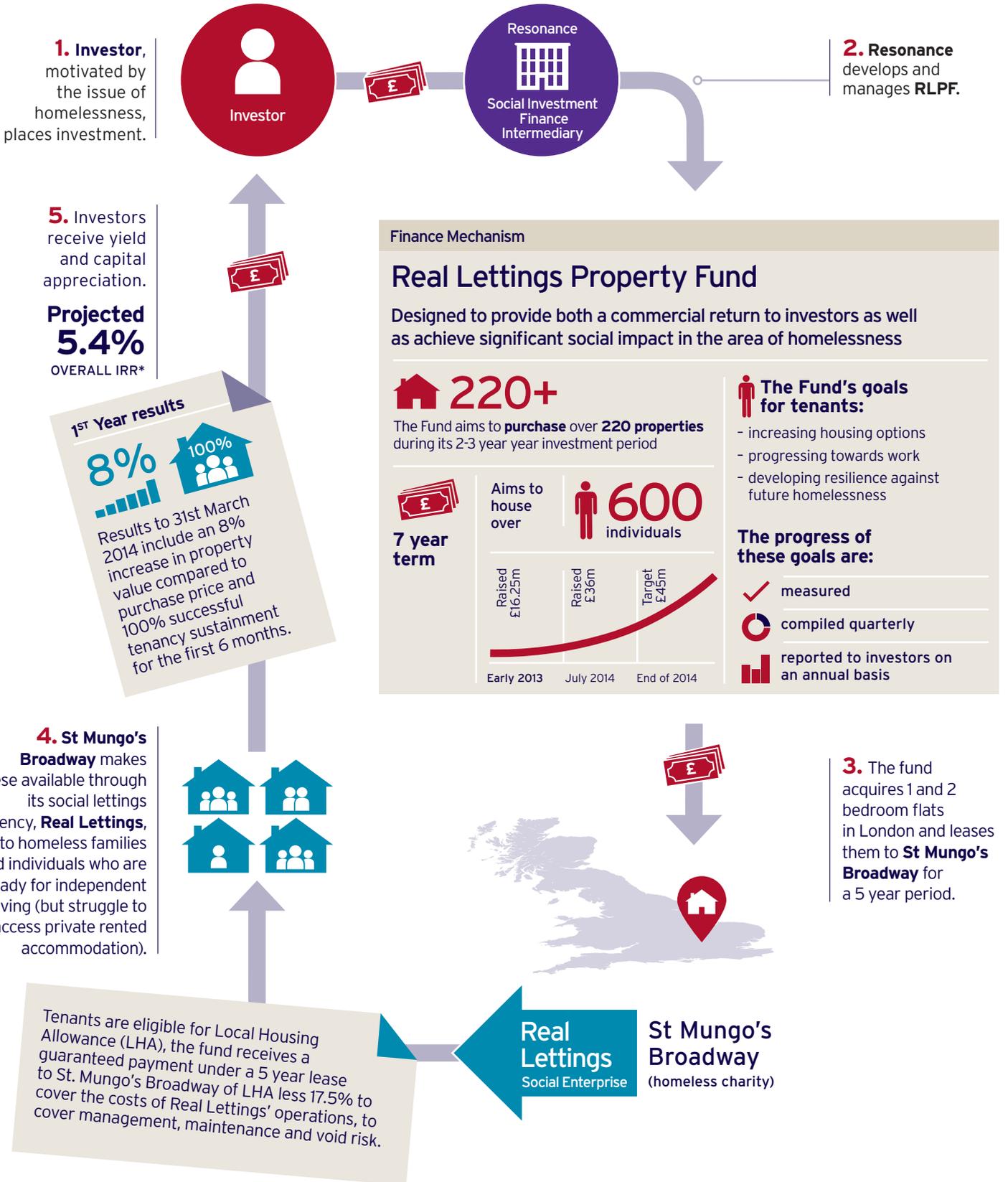
The tax incentives are:

- 30% income tax relief
- Exemption from Capital Gains Tax (CGT)
- CGT deferral available (on gains arising after 5 April 2014)
- Up to 100% inheritance tax relief after two years (on certain qualifying share investments)

The journey of the money/Case study 2

Real Lettings Property Fund (RLPF)

Providing rental accommodation to homeless individuals.



(*assuming RPI inflation for house prices).

Category mapper

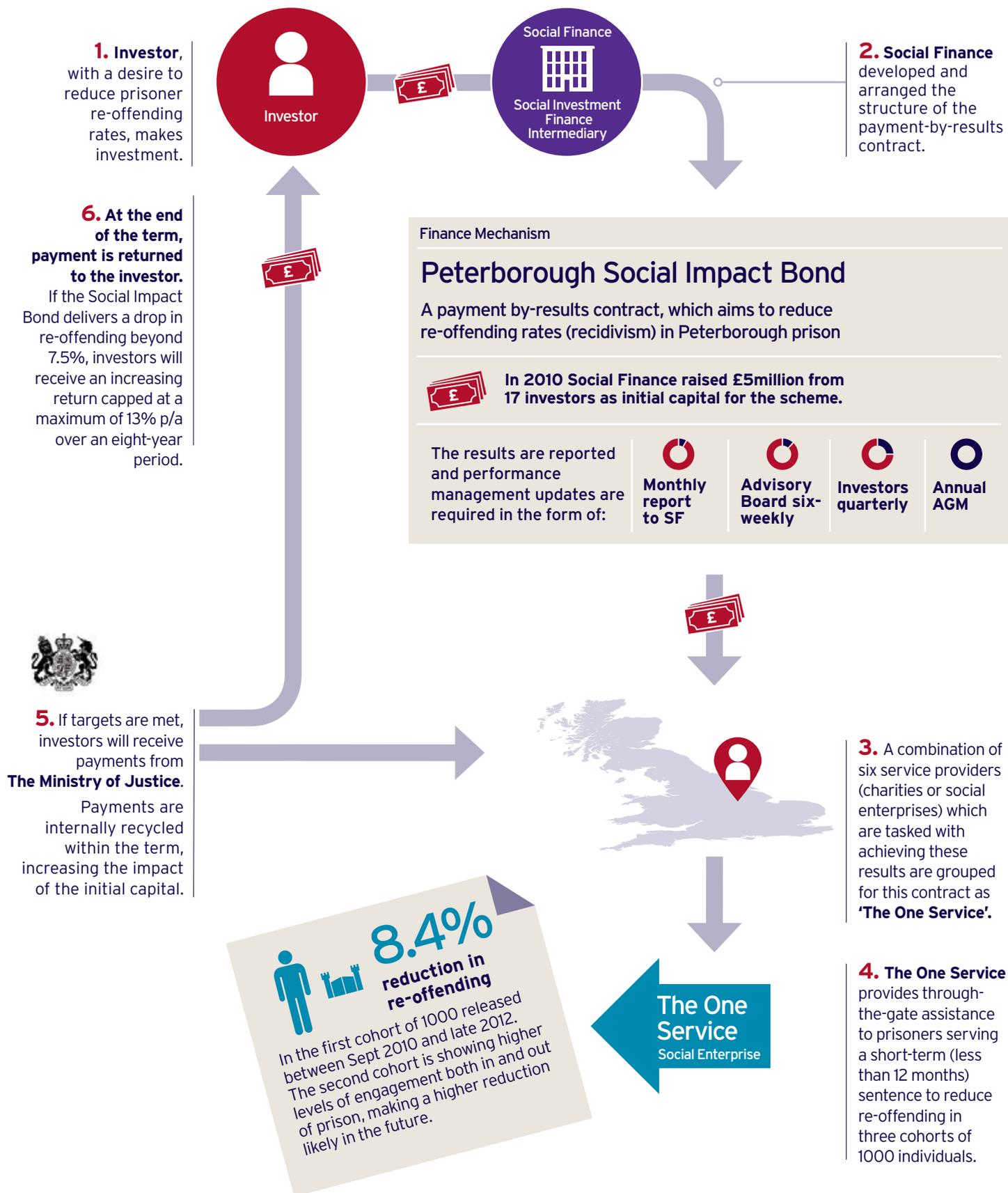
Social enterprises strive to meet a wide range of social needs. For the sake of consistency, and for measurable impact reporting, we have categorised these into seven key areas.

Category	Description	Examples
Development (International & domestic) 	Economic, social or environmental development in a sustainable way including: <ul style="list-style-type: none"> - micro-finance - small to medium business (SMB) support - leadership and business education - infrastructure and energy projects Covers both the domestic and international markets.	Kiva Grameen Bank
Human services 	Alleviating poverty not just financially but also by addressing: <ul style="list-style-type: none"> - hunger - homelessness - access to water - infrastructure 	Real Lettings Property Fund Golden Lane Housing Bond
Human rights 	All aspects of human rights including: <ul style="list-style-type: none"> - democratic representation - rights of minority groups - women's rights - the rights of the disabled 	Who Made Your Pants? Divine Chocolate
Healthcare 	Access to basic healthcare products and facilities, as well as improvements to healthcare research of diseases in developed and developing world such as cancer and heart disease, and malaria and HIV/AIDS.	Living Goods
Arts & culture 	Includes music, visual arts, drama, poetry, the written word, gastronomy, dance and a plethora of specialised forms of cultural expression. Not only involving the promotion of culture and the arts but also broadening access to it.	The Globe Theatre Cultivate London
Education 	From basic education and literacy to higher education and vocational skills. Including: <ul style="list-style-type: none"> - access to education (scholarships, funding etc) - improving the quality of existing education - adult education - special needs education 	Think Forward SIB New Horizons SIB
Environment 	Local environment includes immediate impact schemes e.g. recycling, waste disposal, community improvement and building, as well as related education. Global environment covers wildlife, food pyramids, agricultural impact, global warming and other macro issues.	Community Energy Scotland Westmill Solar Co-operative

The journey of the money/Case study 3

Peterborough Social Impact Bond

Rehabilitating ex-offenders to prevent re-offending.



The future of the market has all the ingredients for growth

UK market statistics

Nearly
1 in 5 businesses has a social mission

Making it a
larger employer than the financial and insurance service industries

Contributing
£55 billion a year to the economy

with a combined annual income greater than...

£160 billion

...and a workforce of more than 2 million people, representing over 4% of Gross Domestic Product and 5% of UK employment.

Global market statistics 2014



£7.5 billion
invested or committed

In 2014, a joint JP Morgan and Global Impact Investors Network (GIIN) survey* of 125 social investors reported that respondents had committed £6.3 billion in 2013, intending to raise that amount to £7.5 billion in 2014.

* JP Morgan and GIIN, (2014) - Spotlight on the Market: The Impact Investor Survey

The UK is a world leader in social investment



1st to introduce a tax relief - to incentivise individuals to invest in social enterprises.



1st to develop investment in Social Impact Bonds - contracts for public services where returns are based on successful outcomes.



1st to establish a wholesale social investment institution - Big Society Capital will commit £600 million into the market.

“SITR will add to the impressive development of the market and stimulate growth”

The private investor has an important role to play

Support for SII has increased significantly in recent years with the founding of a wholesale bank for SII, the introduction of a tax relief for SII investment and a global move toward impact investing as a way to benefit society and the investor.

 **92%** of HNWI's see driving social impact as important:

Of these:
60%
see it as very or extremely important

Rising to:
75%
of HNWI's under 40

Showing how demand from HNWI clients will rise in the coming years.

(Capgemini and RBC, World Wealth Report, 2014)

In the UK, SII enjoys cross party support; Labour first introduced the idea of the wholesale bank for social investment which became Big Society Capital, and in 2014 the Coalition Government introduced Social Investment Tax Relief (SITR).

The Government has shown its ambition and clearly demonstrated it believes the tax system can encourage growth of the market. The introduction of this tax relief shows they believe the private investor can and will play an important role. It is anticipated that SITR will add to the impressive development of the market and stimulate growth, attracting further capital investment from private individuals of as much as £500 million according to HM Treasury.

Of the 92% of High Net Worth Individuals (HNWIs) who see driving social impact as important, 60% see it as very or extremely important. This figure rises to 75% when counting only HNWIs under 40, showing how demand from HNWI clients will rise in the coming years.

The market has all the ingredients for future growth, with an increasing population of investors being attracted to investing their money for social impact as well as financial return.

Conclusion

This document has given an overview of key components of the social impact investment market, including its objectives, mechanisms and aims; we encourage you to further explore aspects of the market that interest you.

More detailed information on the topics covered may be available from your financial adviser, or go to www.gov.uk/ukti.



Worthstone's vision is to see social impact investment established as an integral part of the financial planning process for individual investors in the UK. We aim to achieve this by developing knowledge of the social investment market among financial advisers and becoming the focal point for those financial advisers and product providers who share a desire to see the sector develop and grow.

Worthstone is working with a leading group of financial planning firms and a prestigious law firm, our Founder Partners, all of whom are committed to enabling more individuals to invest in bringing about positive social change.

almus wealth
specialists in impact investment


Arcrate

BpH
Wealth Management

CAVENDISH WARE
WEALTH MANAGEMENT

 **Chamberlyns**
Managing wealth sensibly. Making life simple.

ethical futures
make your money change your world

FARRER & Co

**FLOWERS
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FINANCIAL PLANNING

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**Kingsfleet
Wealth**

 **manse capital**


PageRussell

**Paradigm
Norton**

 **Price Bailey**
PRIVATE CLIENT

SATIS
ASSET MANAGEMENT

 **Trinity**
Wealth Management Ltd

CCLA
GOOD INVESTMENT

CCLA are one of the largest fund managers of charity assets in the UK. They have invested in Worthstone with the aim of strengthening the growth of the social impact investment sector.



UKTI

UK Trade & Investment is the Government Department that helps UK-based companies succeed in the global economy. We also help overseas companies bring their high-quality investment to the UK's dynamic economy acknowledged as Europe's best place from which to succeed in global business.

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