THE LESSONS

we have learned

LESSON #1

BLENDED FINANCE: MORE THAN JUST THE SUM OF ITS PARTS

New entrants to social investment in 2012 who were wildly optimistic about market growth should have their naivety forgiven. Indeed, SASC was one of them. It felt as though grants were in mortal danger and the public sector was (and is) clearly going to go on shrinking. The idea of trying to create a uniquely supportive ecosystem for charities and social enterprises held a lot of promise.

In 2017, three years after the launch of our first fund, SASC spent some time reviewing what we thought we had done well so far and what we needed to change in order to better serve the needs of social sector organisations. After consulting social sector organisations across the UK we relaunched our largest fund offering as the Third Sector Investment Fund (TSIF). This has seen our rate of investment speed up.

A BLENDED FUNDING APPROACH CAN PLAY A VITAL ROLE FOR INVESTEES, GIVEN THE FINANCIAL CONSTRAINTS UNDER WHICH THEY OFTEN OPERATE

There is one aspect of our initial hypothesis that we still hope will play out as expected. This is the belief that SASC would work with charitable foundations to unlock opportunities that would otherwise fall by the wayside.

We got off to a good start. Social Investment Business invested both in our funds and in SASC itself, accommodated us for several years in its offices, and provided a social stamp of approval that allowed us to get out of the starting blocks. Its first-loss contribution to TSIF was innovative and catalytic – a £1.5m investment enabled £30m to be made available to the sector.

In 2015, based on insights derived from previous Social Investment Business programmes, we launched a pilot with the Power to Change Trust that offered a blend of grant and loan. £1m of grant from Power to Change has enabled 6 investments to community organisations that otherwise would not have been possible. The Power to Change grants have leveraged in over £8.5m of funding from SASC and others.

One example of a community organisation that benefited from blended finance is Storeroom 2010, a furniture re-use and training charity based on the Isle of Wight. It needed £440,000 to purchase the building where it stored and sold its furniture, but could not shoulder that amount of debt. SASC was able to provide Storeroom2010 instead with a £360,000 loan alongside a grant of £80,000 from Power to Change. This mix of funding was affordable for Storeroom2010. It allowed the organisation to secure its long term future and increase services to vulnerable families.

In our view, the story elsewhere is more mixed. Rather than trying to complement each other as shown by the Power to Change partnership, foundations and the new breed of social investors like SASC often find themselves trying to participate in the same kind of investment. For large organisations, such as HCT and Five Lamps, this is a significant positive: it helps those larger organisations access more funding than would otherwise be available.

But smaller projects sometimes see established foundations and new social investors competing for the same investment. Arguably, this is less helpful in creating the new ecosystem that is needed. SASC believes in competition. But we also believe that the best way to unlock the growth we all hoped for back in 2012 is to see different funding streams work together, in a way that is most appropriate for a given organisation's stage of development.

Foundations have a strong track record in spotting and backing non-profit organisations with grants, particularly at an early stage, with hugely impressive results. We are proud to have some of these very organisations in our own portfolio, now they have decided they are ready to take on repayable finance. Foundations have been the cornerstone of the sector, long before social investment arrived on the scene. But the larger prize here – social impact at scale – lies in creating a new investment spectrum that unlocks as much funding as possible across the sector.

The "equity-like" investment that foundations can provide, whether in the form of a grant or some other patient capital, is pivotal. Our hope was that foundations would increasingly opt to

work with social investors as part of a blended funding approach. This would ultimately allow grant funding or patient capital to unlock much more funding for organisations seeking to grow.

The six years since our social investment journey began has seen many lessons learned. One of these is that a blended funding approach can play a vital role, given the financial constraints under which third sector organisations often operate. We believe the advantages of this approach should override any concerns that foundations may have regarding "subsidising private profit" (whether in the form of returns to investors or to the managers of the funds). After all, foundations often make grants to organisations that already have commercial mortgages.

SASC will go on making the case for blended investment. We would like to inspire funders whose capital is more flexible than our own to work with us in a complementary way. We have already seen how this can make possible transactions that otherwise would never happen. In the real world, that means more disadvantaged people can gain access to the support they need to improve their lives.

A RESPONSE FROM DAWN AUSTWICK CEO, BIG LOTTERY FUND

BLENDING PRINCIPLE AND PRAGMATISM

A very long time ago I worked in the arts, from the humble Half Moon Theatre to the august British Museum and the fashionable Tate. All these organisations lived or died (sadly the Half Moon did expire) on their revenues – often self generated – and looked at imaginative and clever ways to finance their capital developments, balancing high net worth fund-raising with mainstream loans, underwriting, leasing and public appeals. Blended finance if ever I saw it. So when I moved across into the mainstream charitable sector in 2005 and picked up on the burgeoning social investment bandwagon it seemed on the one hand an entirely logical proposition, and on the other, a rather raucous new club.

Much has changed and not a lot has changed in the intervening 13 years. One welcome change has been a much greater understanding that grants, heaven forfend, can be a force for good. The notion that they are a Luddite technology holding back the market from solving complex social problems is in retreat and this is a more reflective conversation about the complementarity and suitability of different forms of finance than it was five years ago. There is also greater realism about both the efficacy of social investment for some activity (no prospect of return, too complex, too small) and the reduced pot of grant funding available in hard times. If the scarce commodity is the grant funding, we need to nurture it, protect it, and use it wisely.

So this is a good time for the sort of blended finance conversation that SASC want to have. And to do so we have to open up the private gain/public benefit discussion. Many grant funders, and foundations in particular, are charitable entities. As such they have the same corporate form as many of the organisations they fund. They must de facto be driven by mission, as manifest in their deeds or articles of association. Money is a means not an end.

A decision to provide investment rather than grant finance is a balancing judgement about the opportunity cost of capital and where and how 'good' is maximized. These can be easier conversations on capital projects: purchasing a building to transform or expand service delivery, splitting the social investment element from a grant to support the organisational change or soft costs can be straightforward. SASC's support for Hull Women's Network is a fabulous example of a transformative social investment to a visionary and ambitious domestic abuse charity. A hands down case of win win with the social investor providing terms that support the long term sustainability of the charity.

It is altogether harder when commercial returns on operating activity can only be achieved with grant funding subsidising those returns. For a foundation this is an easier sell if the 'investor' is themselves charitable or mission driven so that the seepage of funding out of the 'doing good' sector is minimized. In a period where concerns about inequality are growing, levels of return and the destination of profit are doubly sensitive issues, which leads to the tricky question of 'how much profit is reasonable'?

I have always thought that the point of social investment, unlike impact investing, is that it offers a new paradigm – where financial return is traded for social return. Investors are content to take a lower level of return on some investments because they recognize that they will be generating additional social good. Blended finance runs the risk of sidelining this and operating within the existing paradigm. It comes back to the old adage 'there's no such thing as a free lunch'. For charities and foundations they risk giving the investors a free lunch in order to attract much needed capital.

Payment by result and social investment bond type models however suggest that the lunch can be shared – because the financial benefits in terms of future savings mean much needed social capital can eventually be re-deployed elsewhere, potentially in prevention activity.

And there is of course, a third way. A community owned and funded initiative, such as Bristol Energy Coop, fulfills a mission driven approach with the engagement of multiple social investors – members of the community alongside commercial investment – to create a viable proposition and shared returns.

So as with all good knotty problems, the answers are not straightforward, and no two cases will be the same. We have to tease out the pros and cons, follow both the flow of funds and the achievement of social benefit and map out an appropriate course that utilises both principle and pragmatism.

LESSON #2

PRIVATE AND SOCIAL SECTOR PARTNERSHIPS

Social sector organisations can sometimes extend their reach and generate financial benefits by partnering with the private sector. But the interests of the two organisations need to be aligned. Otherwise, there is a risk that social impact may be sacrificed to financial return if things do not go according to plan.

FLEXIBILITY AND SYMMETRY WILL HELP A PARTNERSHIP TO SURVIVE POST-HONEYMOON TURBULENCE

In 2015 SASC made an investment into Spacious Place Contact (SPC). Our funding helped to set up a call centre that would provide employment and training for ex-offenders and vulnerable people in a supportive environment. Progress was slower than planned in the year following the investment. This is common with start-up businesses, especially those working with challenging beneficiary groups. The private sector partner then unexpectedly found itself needing to boost liquidity and profitability. This meant that the lag in performance created tension between the partners. Ultimately, this proved impossible to resolve within the existing arrangement.

To a newly formed social enterprise such as SPC, the commercial contacts, industry expertise and business acumen of an established for-profit company had initially seemed appealing. There also appeared to be a significant overlap in terms of target beneficiaries. Meanwhile, the private sector partner believed the halo effect of working with a social enterprise partner would be helpful when bidding for public sector contracts.

But supporting people from disadvantaged backgrounds into employment does not always fit easily into more routine business processes (many sub-contractors to Work Programme primes know this to their cost.) The additional time and resources needed in this case to achieve social outcomes created a big challenge for both Spacious Place Contact and an ambitious commercial organisation in a period of high growth. The first 18 months saw initial goodwill (and capital) eroded to the point where the partnership came to an end.

This has been a painful, although not terminal, experience for SPC. Funders have had to be flexible. But the process has ended up creating a revised delivery model. This is less reliant on trading revenues but still seeks to engage with commercial organisations.

For SASC the key lessons are to try and ensure that interests are as strongly aligned as possible right from the outset. Flexibility and symmetry will help a partnership to survive post-honeymoon turbulence. Under the right conditions, we still believe social/private sector partnerships can produce impactful and sustainable delivery models. We will go on looking for opportunities to support them.

LESSON #3

FINANCING PAYMENT BY RESULTS (PbR)

Payment by Results (PbR) is a tool that focuses on results. The private sector takes focussing on results (that is, profit) for granted. But public sector services often lack a profit measure. The result is that public bodies have traditionally commissioned services on a "fee for service" basis. In other words, commissioners have traditionally paid for services based on inputs rather than on outcomes (results).

In recent years, Payment by Results (outcomes-based commissioning) has become increasingly popular. SASC believes PbR can also play a valuable role in social investment. PbR can help focus both commissioners and providers on specific, desired results and improved social outcomes rather than inputs. It can be a way to incentivise successful providers to maximise service effectiveness and potential contractual income by clearly defining what successful service delivery should mean for an individual beneficiary. Successful achievement of stretching outcomes should in turn build up a provider's expertise and may increase their future appetite to bid for high risk contracts that deliver significant impact. And, in a sector that struggles to finance innovation (because it mostly lacks access to equity), PbR is a rare way to fund risky innovation.

Sometimes a Social Impact Bond (SIB) is the best way to put PbR into practice. A conventional SIB involves many parties and uses a standalone special purpose vehicle (SPV). For other situations, SASC has developed a different model which is more flexible and costs less. It also makes the provider a principal in the arrangement, rather than being merely a subcontractor to a Special Purpose Vehicle.

SASC met an established charity, Family Action, which had spent some time developing an intervention. The intervention addressed an area of real need and was genuinely innovative. The Safe Haven project offered a new way of working with highly vulnerable young people in care. These are young people who as a group were at high risk of going missing, exploitation, offending, serial placement breakdown and other negative outcomes. Because it was new, this intervention had no definitive evidence base of its own although it drew on research and practice from across the world. Given Family Action's finite resources of its own, the charity believed it was prudent to find an investor that would share the economic risk of piloting such a bold new service.

OUR EXPERIENCE WITH FAMILY ACTION HAS SHOWN HOW SOCIAL INVESTMENT CAN FOSTER REAL INNOVATION [...] THE HOPE IS THAT FURTHER INNOVATION AND POSITIVE ACTION CAN BE DRAWN FROM THIS PROJECT

SASC worked with Family Action over several months to establish a level of comfort with both the charity and the new intervention it had designed. The intervention had a central feature that appears regularly in this area. It aimed to take a more individualised, holistic approach to a problem where bureaucracy – however well intentioned – has created invisible "silos" that work against beneficiaries' interests. Safe Haven was designed to provide bespoke one to one and round the clock support to a group of vulnerable young people in care. These young people needed a more intensive and relational response than that typically provided by children's social care and other public services.

SASC also developed an award-winning (Social Investment Initiative of the Year – Charity Times Awards 2017) financing model of the kind outlined above: flexible, cost-effective, performance – dependent and aligning the interests of the charity and investor. To be more specific: SASC would only do well economically from this project if the charity achieved a high proportion of the payment by results outcomes; conversely, if the investment was unsuccessful, SASC would share the downside with the charity.

Safe Haven operated for about twelve months off a 100% PbR model which placed all of the delivery risk on the provider and investor. In one sense, the intervention was successful. Two external evaluations of the quality and impact of its service model and of its cost-benefit profile have been positive e.g. showing that it saved double what it cost. Unfortunately, despite this evidence, the commissioners involved decided not to renew the intervention after its first year. Given the positive feedback from the young people, birth families and professionals involved in the project and the evidenced savings generated, this suggests the commissioners may have looked at the savings in a different way.

The key lesson learned from this project is how vulnerable a new PbR project can be to relationships with local authority commissioners and procurement departments, tight budgets and any changes in senior local authority buy-in. PbR projects are complex and involve many parties, and embedding a new PbR approach into an established public sector system brings its own challenges. This was a provider-led intervention where we established a strong relationship and high level of trust with Family Action. The dynamic between commissioner and provider is of course just as important, but is harder for the investor to influence in this more flexible PbR financing model.

Our experience with Family Action has shown how social investment can foster real innovation: Safe Haven has created new evidence that adds to the knowledge of how to help the group of vulnerable young people it was aimed at. The hope is that further innovation and positive action can be drawn from this project.