Building Trust: The essential ingredient for social investment.

1 November 2019

Connect Fund
Building a better social investment market

Key Fund
Growing Enterprise in Communities

Introduction - Matt Smith

Key Fund is a social enterprise, we have no shareholders, we have a focussed mission, a set of clear values that drive the way that we work, and as a team we are very much motivated by the change and impact that we enable our investees to deliver.

So imagine our surprise when during a piece of research work into the barriers that prevent rurally based community and social enterprises from accessing social investment, it became increasingly clear that trust was a major challenge for many potential applicants. Quite simply, they do not trust social investors, our motivations or our intentions. This was a shock for us here at Key Fund as our whole model is based on relationships of trust, where we work alongside applicants and investees to help them to become more sustainable in financial and impact terms, but clearly this wasn't translating. We needed to understand why...

So with the support of the Connect Fund, we worked with a number of organisations and individuals to try to unpick the reasons for this lack of trust. We set out to learn, with a desire to get to the very heart of the matter, and whilst we discovered some misconceptions that were at play, we also heard a number of real life experiences behind the views expressed. The feedback and findings have helped us to identify a number of practical steps that we will take as a fund to address the situation, that I am committed to ensuring are followed through.

I am very grateful for the involvement of the Connect Fund in funding this important work, who have been extremely supportive throughout the project, with their team also providing practical support and advice. I must also thank all of our partners and most importantly of all, the participants who have helped us to understand this issue better - your honesty is much appreciated.

We very much see this as an ongoing process of discussion and development, so would welcome comments or further conversations with all interested parties.

"I think that they should be up front with their financial gain - and not pretend it is all about social development."

North East based social enterprise over 12 months old

1. Bridging the Gap: Addressing a trust deficit in social investment

1.1 Approach

This phase of our project was designed to explore an absence of trust in social investors, directly voiced by local infrastructure organisations (LIOs) in the North East. The issue was first raised at a funding and investment meeting, convened by VONNE, during which it became very clear that several established voluntary sector organisations did not trust the motivation of social investors.

As a social enterprise, the Key Fund has several staff members with over 20 years of experience in the VCSE community. We see ourselves very much for and of the social enterprise movement and part of the wider voluntary sector, but the strength of feeling behind these views came as a surprise to us. We felt a responsibility to better understand what lay behind them. Clearly, if shared more widely, the perceptions expressed would be a barrier to increasing the flow of fit for purpose investment to the sector.

We contacted trusted organisations across the country to get reactions to the opinions emerging from the North East. Responses generally backed up the perception of distrust. Subsequently we discussed the matter with The Connect Fund team, who supported us to dig a little more deeply and better understand the nature of concerns expressed and how widespread they were.

If organisations seeking finance are to benefit from the full range of options available and investors are going to be effective and responsive in the market, these barriers need to be understood and addressed. We formed an approach built on the following methodology:

1) Identify key issues
2) Understand existing thinking
3) Explore the issues across geography, organisational types and sizes

4) Collate results

5) Identify trends

6) Report

1.2 Desk Research

Initial searches suggested there were no locally generated reports or surveys offering formal data on the issue. We therefore commissioned Adrian Ashton, an independent consultant, to look for and review any existing studies that touched on two key hypotheses:

Hypothesis 1

Many local infrastructure organisations do not trust or understand the motivation of social investors and do not consider them part of the sector in the same way as themselves.

Hypothesis 2

Some social entrepreneurs do not like the prospect of a third-party making money from social investment. This might be a social investor, although concerns were expressed about those that finance the social investors, rather than the social investors themselves.

It should be noted that no publications specific to the topic were identified. The research drew on documents addressing parallel and surrounding themes or touching on the matter in their own wider context. However, during the lifetime of this project, both Big Society Capital and Access: The Foundation for Social Investment, have begun to discuss the topic of trust in social investors and social investment.

1.3 Interviews

To test the hypotheses, we commissioned trusted partners to explore the issues with their network. To ensure a meaningful number of responses, reasonable geographic coverage and broad representation of the voluntary sector, we asked five VCS organisations, in five different areas, to carry out interviews with a selection of local grassroots organisations.

Area	No. Social Enterprises Interviewed	No. VCS Organisations Interviewed	Aged 12 months old or less	Over 12 months old
North East	8	2	0	10
Yorkshire	10	0	0	10
Midlands	0	5	0	5
South West Midlands	2	5	5	2
South West	10	4	9	5
Total	**30**	**16**	**14**	**32**

In selecting our partners, we were careful to ensure a diverse range of responses by size of organisation, location, age and thematic focus. We also sought a good split of traditional voluntary sector and trading social enterprises. The identity of respondents remained anonymous to encourage honest feedback. Interviews were carried out by:

1) Locality - North East and Cumbria focus

2) Nottingham CVS - Midlands focus

3) VOSCUR - Bristol and Gloucestershire focus

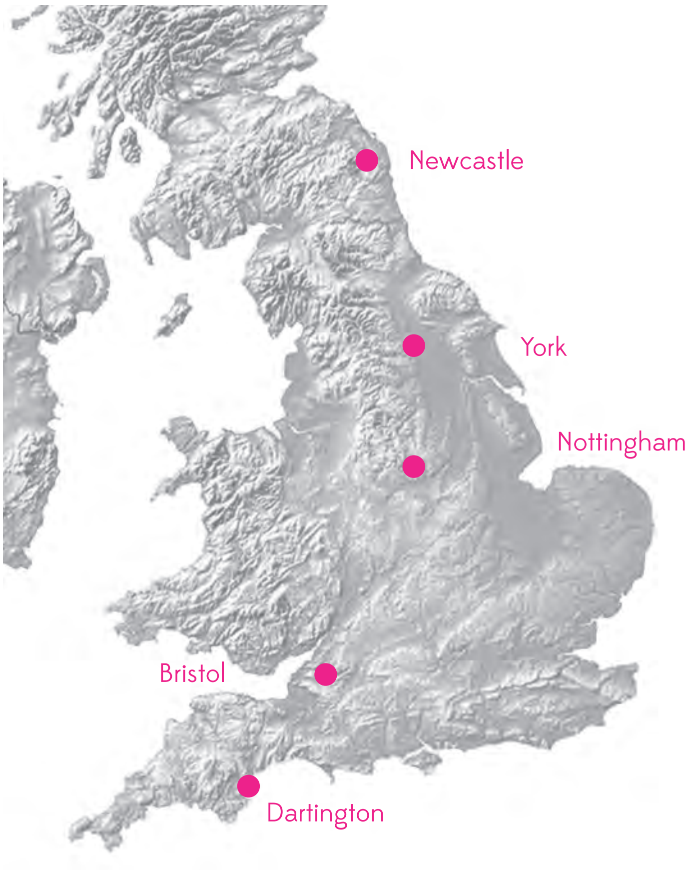
4) SSE Yorkshire and the North East - Yorkshire and North East focus

5) SSE South West - Devon and South West focus

The questions asked were simple and direct.

- **Do you understand and trust the motivation and role of social investors?**
- **If the answer to either of the previous questions was "No", please give an explanation.**
- **What might be done to address this lack of trust?**

It is worth noting that the wording of these questions is very direct, focusses on trust and might have had the effect of amplifying responses, but we do not believe that this was a significant effect. Similarly there were no corresponding questions on the positive impact of investment and investors, although supportive comments were offered by respondents. Importantly we asked for both an explanation for the opinions expressed and evidence to support those opinions. There were some misunderstandings at play, but in the main, opinions were built on either strong ethical considerations or social investment in the context of their market places.



2. Findings

2.1 Desk Research

> **"We question the values and motivation of some of the companies…we'd be prepared to pay the higher rate if we knew the money was going to a good place rather than day rates for highly paid consultants."**
>
> South West based social enterprise

The findings from the desk research were drawn from third party commentary, rather than primary sources, such as the interviews. In summary, they were as follows:

Broadly, LIOs recognise that social investors and intermediaries can play a useful role in and for the sector – so much so that they are beginning to imitate them by exploring enterprise development and provision of social investment. However, this adoption of social investment by LIOs is not without an ongoing critical reflection of this type of finance (NB, often it is the role of social finance, in contrast to grants, which is being considered, rather than the role of providers and intermediaries).

Research suggested social entrepreneurs themselves would not, in the main, be dissuaded from social investment on the basis that such debts are designed to generate a return for the social investor. (However the responses from interviews we carried out presented a very different view). **Rather, there appears to be confusion among investors and potential investees about how to best engage the other so that there is sufficient reciprocal understanding that could form the basis of a successful future relationship.**

With the above in mind, the desk research sets out a series of recommendations:

- Seek to strengthen relationships with LIOs by more open sharing of data sets that explore the impacts of social investment on those ventures who take it.
- Review the information and communications that investors and intermediaries share about themselves so that entrepreneurs might better understand and appreciate their role and operating environment.
- Undertake to publish and share a study of how different social investment packages have been developed and designed. This would be to offer assurance that such investment bodies are seeking to act in the interests, and in response to the needs of, individual ventures, rather than simply pursuing profit or third party policy goals.

> **"I have doubts over the intentions of social investors and would always find it difficult to trust their motivations. I understand the intentions of investment but with all investors there is an expectation of not just repayment but also to profit. It is the profits and where they go that I have a problem with."**
>
> Yorkshire based social enterprise over 12 months old

2.2 Interviews

2.2.1 Analysis of Trust

Interviews did elicit a reasonably balanced view, although our questions were framed consciously to deal with the matter in hand and to draw out evidence to explore some of the concerns previously expressed. Respondents highlighted some good experiences of social investment and social investors. However, three broad areas of concern for social enterprises and charities were:

- Lack of trust in the wholesale providers of finance, specifically around the making of money from the sector and the ultimate sources of funds/ultimate recipients of profit.
- Lack of trust in the motivation and model of the social investors. Do they really care about social value, or are they wearing the clothes of the sector just to make money?
- A disagreement with the basic principle of making money out of social organisations. (We noted the contradiction of trading organisations objecting to other trading organisations making a surplus)

Importantly, there also seemed to be some confusion about the business models of many social investors. There was critique of the use of "highly paid consultants" as well as social investors receiving tax relief for example. These particular findings seem to stem from a misunderstanding of how social investment works, however, the gap that is created between investor and investee because of these perceptions, is real enough.

> **"They get tax relief but what else are they after? Not 100% certain they have the best interests of the sector at heart."**
>
> South West based voluntary organisation

There is clearly a need to ensure there is a much better understanding, not only of the purpose of social investment, but also the underpinning principles and mechanisms for delivery. If people do not understand, why should they have trust in the process?

The opinions expressed in interviews were consistent regardless of the age, scale and location of organisation interviewed. Even where respondents had accessed social investment, some issues of trust and questions about the motivation of social investors remained.

2.2.2 Geographical Trends

We might have hoped that the views expressed in the North East were specific to that geography, so requiring a particular localised response. However, similar views were expressed across the country, uncovering a general spread of both a lack of basic trust in and philosophical barriers to borrowing from social investors.

Interviews across the North East, Yorkshire, The East Midlands, South West and West Country all identified similar views.

The doubts were, in the main, well framed and based on specific experiences or perceptions, but as previously stated, some were based on a fundamenta misunderstanding of the business models of social investors.

> **"I have doubts over the intentions of social investors and would always find it difficult to trust their motivations. I understand the intentions of investment but with all investors there is an expectation of not just repayment but also to profit. It is the profits and where they go that I have a problem with."**
>
> Yorkshire based social enterprise over 12 months old

3. The View from the Sector

Desk research uncovered no written evidence of distrust in social lenders, but it emerged strongly in interviews across the country, regardless of scale and age of organisation, with 56% of respondents expressing a lack of trust. The matter has been raised in recent commentary from Big Society Capital and Access: The Foundation for Social Investment.

While not all respondents distrust social investors, a significant proportion [30%] expressed reservations and a large sample [35%] expressed active uncertainty or distrust. There were, however, a number of common misconceptions about social investors in particular.

We asked the infrastructure organisations, who carried out the sector interviews for this report, to reflect on those conversations and give their sense of prevailing attitudes within the voluntary sector.

VONNE

In our dealings with Local VCSE Infrastructure Organisations we have discovered varying levels of distrust of social investors. Questions such as ‘how are you regulated?’, and ‘where does your money come from?’ were raised in discussions with social investors. Many of the questions indicate a lack of understanding or a misunderstanding of social investors’ legal status and social purpose. There was also some suspicion that social investors were ‘out to get’ VCSE organisations, encouraging them to take out loans, regardless of their ability to repay, which indicates a clear misunderstanding of social investors approach and business model. Some of these suspicions are shared by frontline VCSE organisations but amplified amongst LIOs who essentially we were encouraging to become advocates for social investment. LIOs are generally protective of their member organisations and wary of making recommendations or introductions to organisations, products or services that 1) they don’t know well, 2) don’t have direct experience of dealing with, and 3) don’t fully understand their intent/product/service.

> **“Interest rates on savings are 0.5% but investors charge you 7% interest for borrowing that same dormant money from banks. Everyone is conning everyone”**
>
> South West social enterprise in receipt of social investment

In terms of solutions, we are now working with a number of LIOs in the North East region to encourage them to work in partnership with us on further bids to the Connect Fund. Currently the VONNE Connect Fund is the only VCSE infrastructure-led project in the region and we have discovered that we need more ‘boots on the ground’ to have initial conversations with organisations about sustainability and developing earned income streams and more resource to organise engagement events and training sessions on enterprise development and social investment. As trusted organisations in the VCSE sector, with reach to their members, LIOs are ideally placed for this. We are hoping to work with three LIOs to host an engagement and support post to carry out this work across a number of LIO areas as a shared resource and VONNE will provide specific support, training and advice to maximise the impact and effectiveness of this resource on the ground. We are hoping that, these specialist posts within LIOs will enable the development of specific knowledge and expertise and build relationships with social investors that will enable the myths and pre-conceptions about social investment to be overcome.

SSE Yorkshire and The North East

A few thoughts based on what I have heard and gathered from those social entrepreneurs that I have come into contact with. This is mainly gleaned from those that have started to build a trading model, their enterprises are incorporated and have at least one paid member of staff.

Firstly, it will obviously not be surprising to hear that there does exist a fear when it comes to some social entrepreneurs or social enterprises taking out social investment. Many have a fear of debt and this can be compounded by a risk-averse board. When some organisations are struggling to create and generate earned income, the thought of adding burden and pressure in the form of debt is something many of them are not prepared to enter into. This fear may though be more apparent in the fledgling end of the social enterprises rather than those that have a more established footing and thus a more robust earned income model. This thinking also tends to be more reactionary than a thought-through process.

It is also a challenge to both parties that some may only require small amounts of loan finance and at this level, it is not worth the time, energy and effort for social investment firms. I know there are investment readiness loans and grants, however, is this well-known and is it meeting that need effectively? If not, how else can that gap be met?

It is useful to understand that many view debt as a problem rather than as an opportunity. Many may be unaware of the level of debt that exists in the private sector. Whilst this may not be in any way appealing, it may indicate that in developing commercial opportunities, debt is a natural path to take. I think there also exists a fear that if debt was taken on then what business/coaching support might be available to ensure that, as much as possible, that the investment would be able to be repaid. Some are concerned about receiving the funds and then being left to manage business development and debt repayment alone.

I know that you use case studies to illustrate where investment has been successful, however, maybe there is an opportunity to hear the user voice through video stories. This may go some way to mitigating the fear and open up the opportunity thinking instead.

VOSCUR

My own perception of lender motivation is mixed. I'm pleased that people want to take part in supporting the voluntary sector but worry that the market has really been developed as a response to lack of grant funding availability, rather than by a positive perception of a new opportunity. So the lenders are led to expect a market that isn't really there, or at least not to the extent that some of the marketing might suggest!

Basically organisations want grants, and who can blame them as they are generally easier to manage and very low-risk. It's arguable that this is not the mindset that will lead to more effective and broad-based finance mixes but it's what the senior people in a large percentage of trading Charities are used to and feel safe with. A message that they "must" explore social finance options doesn't lessen their stress or make them more inclined to take risks.

My experience with lenders has also been mixed - some understand the sector, some don't. I don't need to tell you that language is vital and most of the people who run the local VSE sector just don't get it, and never will. I don't think they should be expected to; if lenders and intermediary organisations want people to work with them they must talk in ways that are comprehensible to both parties.

4. Key recommendations

- We need to open out the conversation among investors and engage wholesale providers and market development bodies such as Big Society Capital, Access: The Foundation for Social Investment and Power to Change alongside private trusts and foundations. This will mean working together to explore the concerns raised and collaboration to both address misconceptions and improve the flow of fit for purpose finance where the needs of social enterprises are not being met. This will likely require action by wholesale and retail investors alike and examination of the role of blended finance, truly patient capital and funds shaped to specific markets.

- It is essential that existing trusted national and local infrastructure e.g. NAVCA, VONNE, VOSCUR organisations are involved in the process. They form an obvious bridge between wholesale/retail investors and the social sector at national, regional and local levels
- Encourage openness on sources of capital, costs of doing business, impact and recycling of funds from investors. This might be uncomfortable from time to time, but it is necessary to build trust. A significant factor in creating distrust is a lack of clarity and understanding about the business models used by investors. Collectively, social investors must do more to address this.

Some specific steps for social investors

- Be really clear about what is and isn't an appropriate use of investment. Some activities need to be grant funded.
- Encourage social investors to engage with boards as well as management teams where possible.
- Explore common outcomes with the Equality Impact Investing report and align efforts to address interconnected barriers to investment.
- Discuss the flow of funds from source to final user

Ideas emerging from interviews

> **"I think to build real trust between social enterprises and social investors, people need to see real evidence and connection with what happens to the profits that are generated through these investments"**
>
> Yorkshire based social enterprise over 12 months old

How will The Key Fund put our findings into practice?

Prior to discussions about sharing learning from our project, The Key Fund has discussed how to implement it in our internal practice. The first simple steps are:

- Actively seek speaking opportunities and approach question and answer sessions with a "no stupid questions, no awkward questions" attitude.
- We have always tried to "hide the wiring" behind our offer, to make things simpler for the client. This is not always helpful for the client, when decisions to borrow are based on a mixture of affordability and ethics, specifically regarding the original source of the funds on offer and the return generated for the supplier of those funds. We will increasingly discuss the sources of our capital and the relationships we have with wholesale providers of funds.
- Use our social media activity to be more discursive as well as celebrating our clients and partners.

"Investors could seek "corporate guarantors" who could provide cover for struggling investees as part of a CSR approach.

"Retail investors should push back more on the terms offered by wholesale investors and pass on any savings"

"Investors should provide pre and post investment business support"

Development Trust North of England

With regard to sharing our learning more widely, we are committed to:

- Working with the Connect Fund, NAVCA and regional infrastructure to share tools and embed learning.
- Working with organisations such as Big Society Capital, Access: The Foundation for Social Investment, Responsible Finance and others, to widen the conversation around the role of social investors and the environment in which they operate.