Senate Economics References Committee

Finance for the Not for Profit Sector

Supplementary Submission

September 2011

the Centre for Social Impact

The Centre for Social Impact (CSI) is a partnership between the business schools of the University of New South Wales, the University of Melbourne, Swinburne University of Technology and The University of Western Australia. CSI's mission is to create beneficial social impact in Australia through teaching, research, measurement and the promotion of public debate. It brings together the committed hearts and business heads of the philanthropic, not-for-profit, private and government sectors in pursuit of social innovation. It provides socially responsible business management education and research in the common cause of building a stronger civil society for Australia.

Introduction to the Centre for Social Impact

The Centre for Social Impact (CSI) brings the business, government, philanthropic and social economy sectors together to build community capacity and generate social innovation. Our aim is to help build an Australia renowned for its professionalism and competence in delivering community benefits and social innovation. We do this through collaborative efforts that enable and facilitate those working in or with the social sector to increase their impact. Our areas of focus include:

1. An education program that supports the next generation of leaders whilst providing professional development, mentoring and networking opportunities;
2. The promotion of public debate aimed at creating and transferring knowledge, best practice, trends and developments in the social sector;
3. Evidence based research that measures and demonstrates social impact.

We are a collaboration of the business schools of four university partners: the University of New South Wales, the University of Melbourne, Swinburne University of Technology and the University of Western Australia.

CSI and the Senate Inquiry "Finance for the Not for Profit Sector"

CSI has maintained active engagement and a research agenda that develops and promotes a capital market for social economy organisations in Australia. Key research undertaken by or on behalf of the Centre for Social Impact include:

- The Centre for Social Impact (2011) *Report on the NSW Government Social Impact Bonds Pilot*, The Centre for Social Impact, available online: http://www.csi.edu.au/site/Knowledge_Centre/Asset.aspx?assetid=0b6ef737d2bd75b9
- Kernot, C and McNeill, J (2011) *Australian Stories of Social Enterprise*, The Centre for Social Impact, available online: http://www.csi.edu.au/site/Knowledge_Centre/Asset.aspx?assetid=81476e838a4e4d61
- Burkett, I (2010) *Social Procurement in Australia: National Report,* the Centre for Social Impact (in partnership with Foresters Community Finance, Social Traders, Brisbane City Council, Parramatta City Council, Department of Planning and Community Development VIC) http://www.csi.edu.au/site/Knowledge_Centre/Asset.aspx?assetid=88f8791e732f07e1

- Burkett, I (2010) *Social Procurement: Case Study Compendium*, the Centre for Social Impact (In partnership with Foresters Community Finance, Social Traders, Brisbane City Council, Parramatta City Council, Department of Planning and Community Development VIC) available online: http://www.csi.edu.au/site/Knowledge_Centre/Asset.aspx?assetid=52675a57bd70b7df

CSI is also currently undertaking two research projects that will further contribute to the evidence-base for a capital market for social economy organisations:

- Scoping study of the regulatory environment of the Community Development Finance Institution (CDFI) pilot by the Department of Families, Housing, Community Services and Indigenous Affairs.
- A study of the tax implications of the NSW Government's Social Impact Bond Pilot.

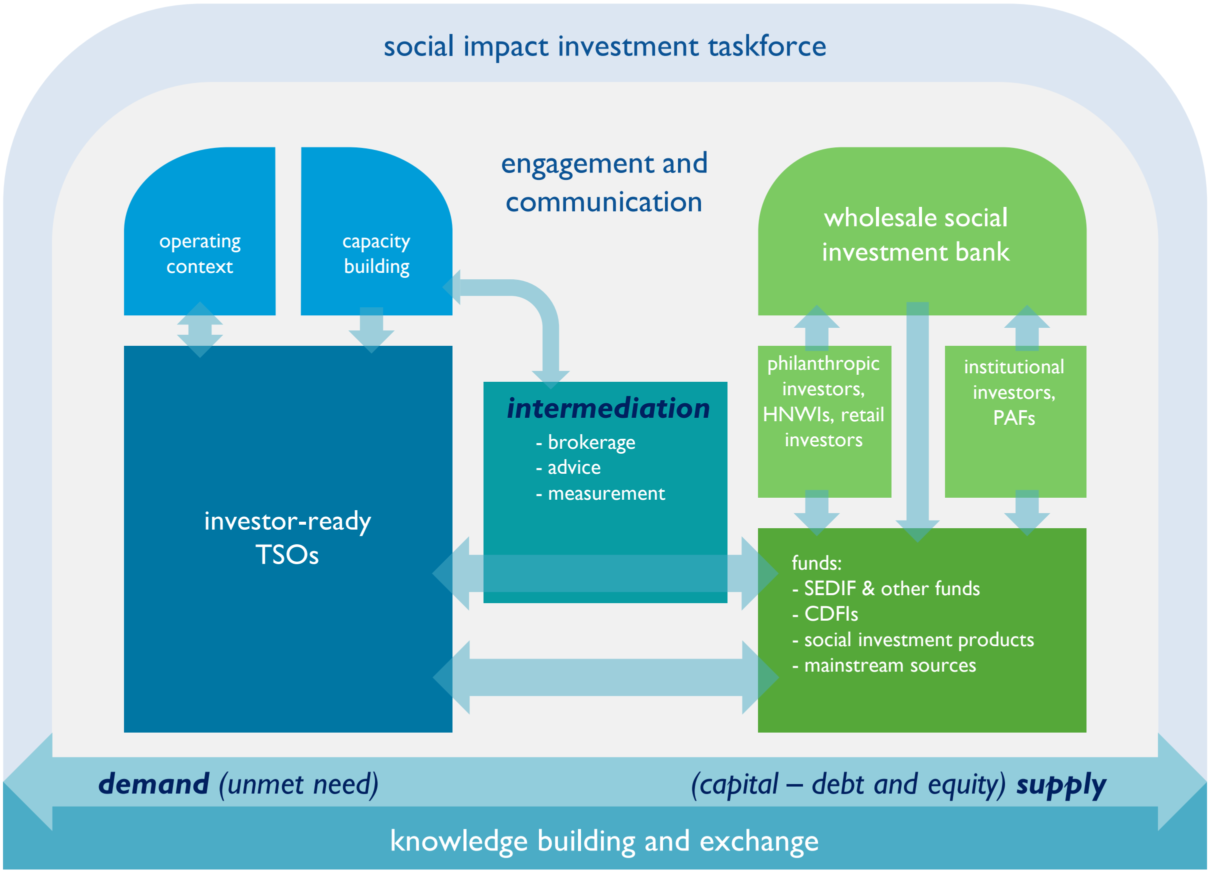
CSI's activities have also involved engagement with government, social economy organisations, investors (including philanthropists, philanthropic institutions and institutional investors), businesses and communities, discussing problem-based transformations and exploring mechanisms and options for the development of a robust capital market for social economy organisations, including not-for-profits, social enterprises and social businesses in Australia.

CSI appreciated the opportunity to appear at a public hearing for the Senate Economics References Committee on Monday, 1st August, 2011. This submission has been prepared to supplement the evidence given at the inquiry and addresses some of the specific terms of reference of the Inquiry.

Finance and the Not-for-Profit sector

It is the view of CSI that a capital market for social economy organisations is a viable and realistic strategy for addressing the market failure of funding social economy organisations in Australia. A capital market provides an opportunity to leverage the diversity, strength and innovation in Australia's social sector to address some of our most complex, entrenched and significant social challenges. Developments overseas point to the potential of capital markets and provide an opportunity for Australia to learn from the experience across other jurisdictions.

Creating a capital market for social economy organisations in Australia will require considerable market development, across three dimensions: supply, demand and intermediation. To build demand, the market will require a strong pipeline of investor-ready not-for-profits and social enterprises, which are structured appropriately to access debt and equity. To enhance supply, efforts also need to be placed on leveraging capital sources from philanthropic sources but also unlocking the considerable amount of capital in traditional investment markets. CSI estimates the potential scale of the capital market for social investment in Australia may reach $7 billion[1]. Finally, the role of market intermediation is crucial: this should include financial intermediaries and competent specialists in accounting, law, IT, governance, and other professional services. This intermediation will be underpinned by an evidence-base of effective and efficient knowledge, measurement and evaluation frameworks and approaches. The diagram below presents CSI's conceptualisation of this market:



[1] CSI has estimated this figure based on research from two sources. The Monitor Institute suggests that the potential scale of the social impact investment market could reach 1% of all managed assets in the United States (Freireich, J., & Fulton, K., 2009, *Investing for Social and Environmental Impact: A Design for Catalyzing an Emerging Industry*. Cambridge, MA: Monitor Institute). It is estimated that funds under management in Australia will reach almost $700 billion in 2011 (IBISWorld, 2011, *Funds management in Australia*. Melbourne, Australia). Combining these estimates, the scale of the market could extend to $7 billion. This estimate excludes assets in superannuation funds. There is approximately $418 billion in over 450,000 self-managed super funds (SMSFs) in Australia (Australian Taxation Office, 2011, *Self-managed super fund statistical report – June 2011*; ATO, Canberra), if these generated a further $4 billion the scale of the market reaches $11 billion. The scope of the market would increase even more dramatically if some portion of Australia's estimated total of $1.3 trillion of assets held in the Australian Super Funds industry were unlocked. For further information and discussion of potential sources of social investment capital in Australia see the Centre for Social Impact (2011) *Report on the NSW Government Social Impact Bond Pilot*, Centre for Social Impact, Australia.

(a) the types of finance and credit options available to not-for-profit organisations, social enterprises and social businesses, the needs of the sector and international approaches

The needs of the sector (particularly social enterprises) has been explored and articulated by Foresters Community Finance[2]. This research found that many social economy organisations are most in need of certain types of capital, including:

- Growth capital to scale up or replicate services within the organisation;
- Capital to increase productivity and smooth cash flows (which both can present barriers or challenges to service providers);
- Long-term capital to encourage sustainability, such as through the use of assets such as premises, human resources and equipment;
- Capital for use in funding innovation, research and development;
- Capital designated for the sharing of risk, bringing forward investment in place of fundraising efforts that can be resource intensive and time consuming.

Foresters Community Finance has also explored the types of capital available to social enterprises, and their associated advantages and disadvantages. These findings have been extracted in Appendix I. We encourage the Inquiry consider the findings of this research.

[2] Burkett, I. (2010) *Financing Social Enterprise: Understanding Needs and Realities*, Foresters Community Finance, Melbourne, available online http://www.foresters.org.au/images/stories/publications/financing_social_enterprise_understanding_needs_and_realities.pdf

(b) the role and current activity of financial intermediary organisations and how these can be strengthened

It is the view of CSI that intermediaries will play an instrumental role in an Australian capital market for social economy organisations. Efforts to unlock the supply of capital and nurture organisations demanding capital must be accompanied by efforts to encourage and empower intermediaries. The role of intermediaries should not be considered to be exclusively financial, with other intermediary organisations such as legal practices, accounting firms, professional advisory services, IT services and governance support organisations also a necessary component of a capital market. It is CSI's view that the institutional infrastructure for intermediation in the capital market for social investment is immature and necessitates further development[3].

Intermediaries are crucial for an effective market as many social economy organisations in Australia are not yet investor-ready and need a variety of support mechanisms to develop capacity to present sound financing propositions and take on debt. Nonetheless, the scale and scope of specialist support for social economy organisations in Australia remains limited (and includes both Social Ventures Australia using a consultancy model, and Foresters Community Finance using a vertically integrated model). A number of other professional organisations (e.g. law firms) provide pro-bono or low fee support to social economy organisations but the delivery of these services remains relatively ad-hoc and not systematically tailored to the needs of social economy organisations, especially with respect to attracting investment. There are a small number of mainstream advisors to institutional and individual investors that now endorse social investment. These mainstream advisors are restricted by the sole purpose test and fiduciary duties, and rely on recommending 'investment grade' investments. A number of specialist advisors have also emerged to address demand for ethical investment[4] and to provide advice around the operation of Private Ancillary Funds (PAFs).

The role of effective measurement and evaluation frameworks forms a necessary foundation for a capital market for social economy organisations. This can ameliorate the considerable level of information asymmetry between parties to social investment. To encourage the 'blending'[5] or 'sharing'[6] of social and financial value there must be effective measurement, evaluation and reporting frameworks. The integration of multiple sources of value in a single reporting approach is

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[3] See also Mulgan, G., Reeder, N., Aylott, M., & Bo'sher, L. (2010). *Social Impact Investment: The opportunity and challenge of Social Impact Bonds*. The Young Foundation, London.

[4] One example of an ethical investment advisory firm is Ethinvest, who hold an Australian Financial Services Licence and advises both high net worth individuals and self-managed super funds: http://www.ethinvest.com.au/Home.html

[5] Emerson J. (2003) "The Blended Value Proposition: Integrating Social and Financial Results", *California Management Review,* 45 (4), pp 35-51

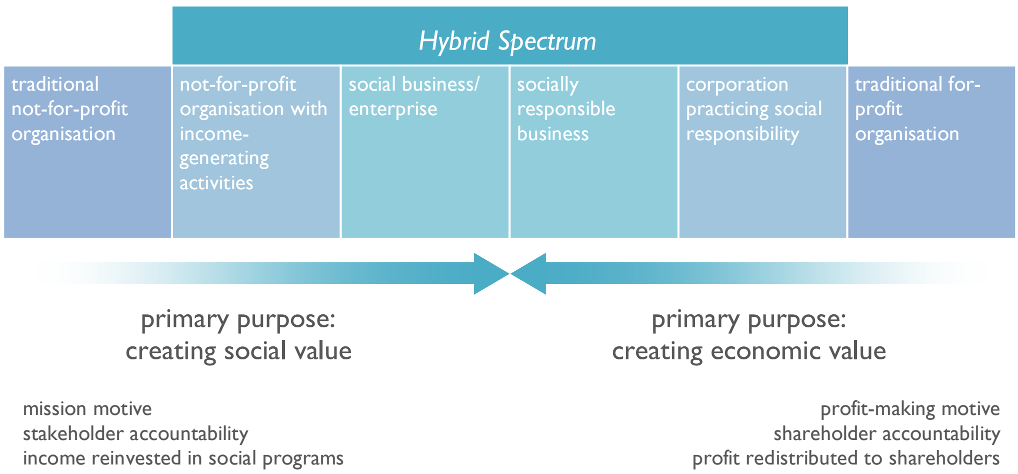
[6] Porter M. E. and Kramer M. R (2011) "The Big Idea: Creating Shared Value: How to reinvent capitalism – and unleash a wave of innovation and growth", *Harvard Business Review*, January-February 2011.

the aim of the International Integrated Reporting Committee's Integrated Reporting Framework, with a discussion paper due for release later in 2011. In addition, the Impact Reporting and Investment Standards (IRIS) is developing an independent and credible set of metrics for measuring social and environmental performance and the Global Impact Investing Rating System (GIIRS) is exploring a ratings approach to assessing social and environmental impact. We encourage the Inquiry to consider the approaches taken by these initiatives[7].

(c) strengthening diversity in social business models

It is the position of CSI that diversity already exists in Australia's social business sector, however that this diversity needs appropriate scaffolding to maximise its potential. Adapting Alter's[8] Typologies of Hybrid Organisations illustrates the diversity in social business models that is evolving in Australia and elsewhere. This spectrum demonstrates the spectrum of organisation types which blend levels of social and economic purpose and value.

Typologies of Hybrid Organisations (adapted from Alter, 2007)



The key driver of change in the social economy landscape is the blurring of traditional boundaries between economic and social purpose or mission. Both market failure and unmet social need have driven the emergence of hybrid organisations (with social enterprises as a popular example) that seek to generate both social and financial value. CSI has prepared a series of case studies that illustrate some of this diversity in the Australian context (see Appendix II).

Blending social and economic value has created many examples of social innovation which have an emphasis on productivity and effectiveness (for example Goodstart Childcare Limited). It is the

[7] The respective websites of these initiatives are IIRC: www.iirc.org; IRIS: http://iris.thegiin.org and GIIRS http://giirs.org

[8] Alter, K. (2007) *Social enterprise typology*, available online http://www.virtueventures.com/setypology.pdf

position of CSI that it is imperative that the promotion of social innovation is captured in a suitable legal form. Legal structures can have considerable impact on the ability of social businesses to access capital, and to explore more innovative approaches to unmet social need. The most common legal forms adopted by social economy organisations in Australia (companies limited by guarantee and incorporated associations) are associated with limited access to capital through debt financing (i.e. overdrafts, leasing arrangements, short-term loans, mortgages and hire-purchase agreements). In addition, equity investments are not appropriate for those social businesses that are prevented from disbursing dividends, nor those with management concerned by losing control of their organisation. A quasi-equity investment is considered the most appropriate alternative[9]. In addition, the choice of existing structures can be confusing for many social economy organisations, especially when few legal professionals are familiar with the range and nuances of alternative structures[10].

The advantages and unique place of cooperatives and mutual organisations are often overlooked in this discussion. Cooperatives are a legal form that incorporates both debt and equity, but can also enable community ownership, attracting capital from often-untapped sources of community and external investors (two examples include the Hepburn Community Wind Park Cooperative[11] and the West Belconnen Health Cooperative[12]). Additionally, there are successful instances of community buy-outs of Australian businesses (including fuel retailers, general stores and hotels[13]).

CSI believes there is a need for a systematic investigation into the efficacy and suitability of existing and possible legal forms for Australian social businesses. The opportunities and challenges of our current legal forms have been elucidated by Foresters Community Finance, and are extracted below (next page). Despite other limitations, one historical legal form (the company limited by shares and guarantee) did offer a means for charitable organisations to access working capital, and may provide a useful starting point for a discussion on the role of such hybrid legal forms may play in the Australian social economy landscape. Consideration of legal forms that have emerged across other jurisdictions may inform his discussion, including the *Community Interest Company (CIC)* in the UK, the *Low-Profit Limited Liability* (L3C) and the *Benefit Corporation* (B-Corp) from the USA, and the *Co-operative Society of Collective Interest* (SCIC) from France (and other similar cooperative legal forms across Europe). It is important to note that an appropriate legal form which allows the explicit recognition of the values and social mission of an organisation may be a new creation, or alternatively may be enacted by a small change to existing legal forms (such as the L3C form in the USA, created by an amendment to the General Limited Liability Company Act).

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[9] Social Ventures Australia (2009) *Funding needs of social enterprises in Australia*, SVA, Sydney.

[10] PilchConnect (2009*) Submission to Productivity Commission's study into Australia's non-profit sector*, submission, Public Interest Law Clearing House (PILCH) Inc, Melbourne.

[11] See http://hepburnwind.com.au

[12] See http://www.westbelconnenhealth.coop

[13] See http://www.coopdevelopment.org.au/communitybuyouts.html

Australian Legal Forms: Challenges and Opportunities[14]

Legal Structure	*Challenges*	*Opportunities*
Proprietary Limited Company (Pty Ltd)	Tax liability. Can be difficult to structure in a 'for benefit' clause or social mission. Difficult to access grants or philanthropy.	Ease of setting up and reporting. Relative ease of attracting investment capital and debt capital. Governance structures can be relatively straight-forward.
Company Limited by Shares (Ltd)	Can be difficult to enshrine the social mission into the structure long-term (equity partners may not always share original social vision).	Capacity to offer and hold equity capital.
Company Limited by Guarantee (Ltd)	No options for equity capital. High establishment and compliance costs.	Can offer some of the benefits of both corporate and not-for-profit worlds and therefore access to earned income, debt capital, and grants/philanthropic capital. National registration means that they can trade nationally.
Co-operative *- Trading (for profit)* *- Non-Trading (not-for-profit)*	Reporting and governance structures can be onerous. Can be less understood by financial institutions and investors.	Can build share capital into the structure. Can join social mission and objectives with democratic governance and a legal structure that draws on the benefits of company law.
Incorporated Association (Inc)	Can be quite difficult to attract non-grant capital. Can be hard to develop a culture that moves beyond grants.	Can be best where the social mission is much more pressing than the possibilities for business returns.
Partnership	Can be risky financially for the partners involved. Can be difficult to access grant or philanthropic capital and to build in the 'for benefit' or social mission (with not-for-profit intentions) into the structure.	Can open up possibilities for accessing a wider range of options for non-grant capital.

[14] Extracted from Burkett, I. (2010) *Financing Social Enterprise: Understanding Needs and Realities*, Foresters Community Finance, Melbourne, available online http://www.foresters.org.au/images/stories/publications/financing_social_enterprise_understanding_needs_and_realities.pdf

(e) government actions that would support the potential for social economy organisations involved in the delivery of government services to access capital markets

The provision of social services by government has been under transformation, driven by limited resources, unmet social need of increased scale and complexity as well as regimes focussed on value-for-money. For some social services, social economy organisations offer comparative advantages, including in terms of innovation, flexibility, multi-stakeholder engagement and proximity to client groups with complex problems. Social economy organisations are often cost-effective service providers as they are able to leverage philanthropic resources, volunteer time and pro bono contributions to enhance and often subsidise program delivery. Indeed governments have the potential to foment innovative approaches to unmet social need. At the federal level, this includes the National Rental Affordability Scheme, the Community Development Financial Institution (CDFI) pilot and the Social Enterprise Development and Investment Fund (SEDIF). Governments are increasingly focussed on delivering long-term outcomes and impact, leading to the introduction of outcome-based agreements, results-based accountability or payment for success mechanisms.

Some of the greatest opportunities for effective government action to promote access to capital markets lie in outcome-based commissioning of government services. There is much work being undertaken in Australia and overseas into outcome-based commissioning instruments, including the social impact bond[15]. Recent developments overseas include the announcement of £40 million trial social impact bond targeting disadvantaged families in four communities in the UK[16], and a Request for Information in the state of Massachusetts in the USA into social innovation financing[17]. In Australia, CSI has completed work that considers the feasibility of a social impact bond in NSW[18], and is now investigating its tax implications. This research showed that there is tangible interest among all investors for a social impact bond in NSW, and that there are a number of social economy organisations that were legally able, competent and interested in formulating and executing a social impact bond. CSI has identified a number of social impact bond proposals that are close to realisation, one of which may achieve an investment grade rating and thus attract the interest of institutional investors.

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[15] The One* SIB has been operating in the UK since October 2010 by Social Finance UK in the Criminal Justice sector. More information is available: http://www.onesib.org/

[16] Cabinet Office (2011) *Big Society innovation aims to get families out of deprivation*, press release, available online: http://www.cabinetoffice.gov.uk/news/big-society-innovation-aims-get-families-out-deprivation

[17] Commonwealth of Massachusetts Executive Office for Administration and Finance (2011) *Massachusetts Pursues Social Innovation Financing to Spur Innovation and Build on Program Success,* press release, available online [http://www.mass.gov/?pageID=afpressrelease&L=1&L0=Home&sid=Eoaf&b=pressrelease&f=social_innovation_financing&csid=Eoaf

[18] The Centre for Social Impact (2011) *Report on the NSW Government Social Impact Bonds Pilot*, The Centre for Social Impact, available online: http://www.csi.edu.au/site/Knowledge_Centre/Asset.aspx?assetid=0b6ef737d2bd75b9

Key to encouraging this unique instrument is the development of outcome-based assessment systems. Implementing a social impact bond requires the establishment of a range of outcomes-based payment regimes. These regimes will be crucial for encouraging social economy organisations as well as interested investors. This will also be predicated on effective knowledge, measurement and evaluation bases. Another important step in the development of the outcomes-based commissioning approach will be to run a series of demonstration projects. CSI considers this critical to encouraging wider adoption of social impact bonds. The demonstration projects could focus on policy areas where results based funding is already utilised (such as pathways to employment) or other policy areas where robust outcome measures can be formulated and where there is a robust evidence base.

A second important opportunity for government action lies in procurement processes. Promoting social procurement recognises and places value on the additional benefits that are provided by social businesses. This also presents a unique opportunity for local governments to be involved in supporting local social businesses and enterprises. CSI has commissioned research into the applicability of Social Procurement, and this approach has now been rolled out across Victoria[19].

(f) incentives to support investment in the sector

This refers to a crucial area of the market that requires further investigation. This may form part of the remit of a Social Investment Taskforce, as highlighted by a number of witnesses at the public hearing in Canberra, 1st August 2011.

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[19] Burkett, I (2010) *Social Procurement in Australia: National Report*, The Centre for Social Impact (In partnership with Foresters Community Finance, Social Traders, Brisbane City Council, Parramatta City Council, Department of Planning and Community Development VIC)
http://www.csi.edu.au/site/Knowledge_Centre/Asset.aspx?assetid=88f8791e732f07e1

(h) making better use of the corpus of philanthropic foundations and trusts to make investments in Australia's social economy organisations, expand socially responsible investments and impact investments and any current barrier to their investment

The approach of philanthropists and philanthropic foundations has been subject to considerable transformation, with attitudes to giving becoming far more engaged and strategic. While interest by institutional investors in impact investing has remained constrained, investments by the Christian Super Fund represent a precedent for impact investing in Australia by pursuing both strong financial returns and a valuable contribution to society and the environment (its investments have included microfinance and recently, SEDIF). Nonetheless, the sole-purpose test and regulation of fiduciary duties is considered a limitation by many other trustees considering social investments. In April 2010, Senator Nick Sherry stated:

> *"What I find striking is that you can argue with superannuation trustees, as you can argue, more strongly, with the trustees of private ancillary funds (PAF), that they do have, as part of their trustee duties and obligations, a greater need to consider broader environmental and social issues than they did 20 or 25 years ago - because society has changed.*
>
> *"The argument about trustees' duties and obligations is that trustees, in common law, broadly need to reflect society and, particularly, the goals of the organisation that they owe a fiduciary duty to. Therefore, the role of a trustee in a superannuation fund, and the role of a trustee in a PAF, today is very different from the role they would have had 20 or 25 years ago, for the obvious reason that the world has changed. The world in which we are considering issues of investment, the placement of funds and the distribution of funds requires a consideration of a much broader and almost certainly more complex set of issues than 20 or 25 years ago. I think for a PAF, it's even more important to consider these issues because invariably, the stated goal of a PAF will have a direct link to issues relating to socially responsible investment...*
>
> *"...Trustees, I would argue in today's world, actually need to go further than simply passing the money over to a financial institution. They need to be actively engaged in examining where that financial institution is placing those investments - not just to maximise the return to the fund but also to ensure that where those monies are invested aligns with the interests of the fund itself. So what the law arguably requires from trustees is a significantly broader range of activities than in the past, as well as a consideration of a more complex set of issues."*
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> *(Address given at the CSI Investing for Impact Conference, Melbourne, 8 April 2010.)*

(i) policies, practices and strategies that affect the availability of capital markets for social economy organisations on social innovation, productivity, growth and workforce issues in these sectors

It is the view of CSI that efforts to develop an effective capital market for social economy organisations must also focus on building the capacity within social economy organisations. There is often a lack of awareness and a risk aversion towards finance across many social economy organisations. This cultural fear of debt precludes many organisations from considering the options for financing that may be offered in a capital market for social economy organisations.

In addition, a significant barrier to access finance remains the inability or lack of capacity within social economy organisations to formulate compelling propositions to present for investment. In particular, the complexity, resource-intensiveness and expertise required in the formulation of proposals can prove insurmountable for many organisations[20]. This is a significant medium- to long-term challenge that may be ameliorated by growing the scope of specialist intermediaries (see our response to Term of Reference B).

Further specific work is required on the policies, practices and strategies that affect the ability of capital markets for social economy organisations. A current scoping study being undertaken by CSI into the regulatory and policy environment for CDFIs (on behalf of the Department of Families, Housing, Community Services and Indigenous Affairs) will contribute to the body of knowledge in this area. The preliminary findings of this study will be concluded by late 2011.

[20] The extent of these challenges are outlined in CSI's report on the feasibility of a social impact bond: The Centre for Social Impact (2011) *Report on the NSW Government Social Impact Bonds Pilot*, The Centre for Social Impact, available online: http://www.csi.edu.au/site/Knowledge_Centre/Asset.aspx?assetid=0b6ef737d2bd75b9

Appendix I

Grant Capital: Innovations For Ensuring Relevance And Impact For Social Enterprise[21]

Innovation	*Benefit/Purpose*	*Structure/instruments*
High Engagement Grants	• Long-term grant relationships specifically focused on and structured for building capacity and ensuring the long-term viability and sustainability of the enterprise. • Structured to build capacity and stability in the enterprise, for example, development and maintenance of business plans; development of appropriate financial management systems. • Ensuring that the grant does not undermine the meeting of core operational costs of the business for any length of time.	Treated the same way as traditional grants in the financial records, but the relationship is structured in longer timeframes, with funding focused on building the core of the social enterprise.
Repayable Grants	'Grants' that are structured to mirror more investable and rigorous finance forms such as debt or equity, by including clauses for repayment of some or all of the grant once the enterprise achieves certain financial thresholds or milestones.	Could be structured as subordinated debt or could be treated as traditional grants but with contractual agreements around the conditions of repayment.
Matched Grants	Grants that match the surplus/equity that the enterprise earns over a particular period, thus incentivizing the enterprise to ensure that they make a surplus from trading or production. The purpose could be to build the equipment or asset base of the enterprise in order to assist in the growth and development of the business.	The rules around the grant would need to specify what amount of monies could be matched, and the grant could be treated as a gift or traditional grant in the accounts of the enterprise.

[21] Extracted from Burkett, I. (2010) *Financing Social Enterprise: Understanding Needs and Realities*, Foresters Community Finance, Melbourne, available online http://www.foresters.org.au/images/stories/publications/financing_social_enterprise_understanding_needs_and_realities.pdf

Debt Capital: Innovations For Ensuring Relevance And Impact For Social Enterprise[22]

Innovation	*Benefit/Purpose*	*Structure/Instruments*
No Interest Loans	Enabling enterprises to build their confidence and capacity to engage with debt finance but do so without the burden of interest payments. The conditions and assessments are such that it is clear that the enterprise is willing and able to repay the capital, but there are no interest charges (although there may be a small administration fee).	No Interest Loans are common in the personal finance space in Australia (see Burkett and Sheehan, 2009; Good Shepherd Youth and Family Services). Foresters Community Finance also has experience of lending at no interest to microenterprises and social enterprises. This sort of lending requires rigorous structures (as even lending at no interest can be irresponsible if the appropriate assessment processes are not in place); and some subsidisation of administration costs as these are not covered in the lending process.
Low Interest Loans	Lending at below market interest rates for the purpose of building the capacity of enterprises in a disciplined lending environment without the fully commercial interest rate burdens. Often in conjunction with particular capacity building programs	Often undertaken by a mainstream financial institution in partnership with a capacity building intermediary. The loan is administered by the financial institution and complies with all relevant financial regulatory requirements despite offering below market interest rates.
Commercial Interest Loans but with special conditions	Loans at market rates but with flexible conditions such as unsecured loans, repayment holidays or built in capacity-building processes.	These sorts of loans often require some subsidization, and must be offered within the legal and regulatory frameworks governing credit and lending practices. These sorts of loans have often been managed by CDFIs overseas.
Above market interest loans with patient conditions	Lending to social enterprises can be risky and costly for lenders. This form of lending would be for cost-recovery (covering all the transaction costs of the lender and aiming for a sustainable surplus), but with conditions that are focused on assisting the enterprise to achieve their social objectives and impacts. So, while the interest rates and fees associated with this sort of lending may be more costly than other market rates, the conditions would be based on a long-term relationship, where they may be repayment holidays, flexible repayment plans or other 'patient' conditions to the loan.	This sort of lending is often undertaken by CDFIs who themselves need to achieve a degree of financial sustainability but whose purpose is focused on ensuring that sectors who cannot access mainstream finance have access to debt capital that is developed to meet their specific needs.

[22] Extracted from Burkett, I. (2010) *Financing Social Enterprise: Understanding Needs and Realities*, Foresters Community Finance, Melbourne, available online http://www.foresters.org.au/images/stories/publications/financing_social_enterprise_understanding_needs_and_realities.pdf

Equity Capital: Innovations For Ensuring Relevance And Impact For Social Enterprise[23]

Innovation	*Benefit/Purpose*	*Structure/Instruments*
Quasi Equity *Equity-like Investment*	The provision of capital that has equity-like qualities in that it can help to grow the enterprise and provide sufficient capital for this growth without tying the capital to particular purposes. There is an expectation of both social and financial returns on the part of the investor.	Equity-like investments where the legal structure doesn't exist to support equity investments. The equity is structured as subordinated debt, and instead of dividend payments for example, there could be royalty payments when the enterprise reaches particular revenue goals (see for example, Bridges Community Ventures, www.bridgesventures.com and Howard, 2004). The key to structuring such investments is to develop exit strategies for the investors.
Patient Equity	Provision of equity capital for growing and consolidating social enterprise with the expectation of some form of financial return at some point in time when the revenues of the enterprise are sufficiently high. In the meantime the equity holder may play a capacity building role in the governance of the enterprise.	Like the above, this kind of equity is usually structured as subordinated debt (in this case, deeply subordinated), with an expectation that there will be some level of financial return, but with an emphasis on the nature of the social return that can be generated from this capital.
Social Enterprise Equity	The development of real equity investment into social enterprise is possible with the use of the appropriate organisational legal structures. The benefit of this is that the social enterprise can raise capital at any stage of their development.	Real equity investments in social enterprise are possible. However, this requires that the enterprise has a legal structure of 'Company Ltd by Shares', or co-operative with shares. May be structured with reduced financial returns to investors, but maximum social returns (for example, this could be a focus for Mission Related Investments – MRIs). Currently relatively few social enterprises are structured to take advantage of potential equity investments, and there are few options for finding potential investors.

[23] Extracted from Burkett, I. (2010) *Financing Social Enterprise: Understanding Needs and Realities*, Foresters Community Finance, Melbourne, available online http://www.foresters.org.au/images/stories/publications/financing_social_enterprise_understanding_needs_and_realities.pdf

Features Of The Major Types Of Capital As They Are Applied In Social Enterprise[24]

	Grant Capital	*Debt Capital*	*Equity Capital*
Advantages	Non-repayable. Virtually 'risk-free' (although the move to outcome funding is changing this). 'Known' form of capital – particularly to those social enterprises that stem from community or welfare sectors.	Flexibility in use – Uses of capital can be much more determined by the enterprise rather than by an external body such as a funder. Can be long-term. Can assist in building financial discipline into the enterprise and strengthening management and planning.	Provision of larger amounts of capital for growth. Returns are based on income. Can be long-term. Can assist in building financial discipline into the enterprise and strengthening management and planning.
Disadvantages	Often restricted to particular projects or outcomes which may represent a distraction for the enterprise. Often do not contribute to the development or sustainability of the enterprise itself – solely focused on funding program outcomes. Often focused on short-term projects rather than long-term sustainability of the enterprise. Often relatively small and targeted so cannot help to consolidate enterprise development or growth. Time consuming and bureaucratic application processes with long lead times.	Is repayable under the particular conditions set out in the loan contracts – so requires careful analysis, as these conditions are not always flexible enough to assist enterprises. Requires that the enterprise maintains adequate levels of income over a long period of time. Generally requires some kind of loan security. Often require risk assessments which can be difficult for social enterprises to meet.	Can be difficult to structure 'pure' equity arrangement because this requires the enterprises have particular legal structures. If investors condition their investment with some form of 'control' in relation to the management or governance of the enterprise this can create concern about takeover or mission shifts. May be significant costs involved in offering stages and in monitoring for investors.
Best uses	Support, participation and impact costs. Infrastructure and development costs. Specific projects. Initial program development.	Purchase of assets and equipment to develop the enterprise. Use of short-term working capital to smooth cash flow lumpiness.	For social enterprises that have good scale and income potential but who may lack the capital to develop these. Soft and untied development costs e.g. staff development – can't be financed through debt capital.
Pitfalls for Social Enterprises	Can lead to some level of dependency and constrain development of 'enterprise' or 'business' focus. Can detract from development of financial rigour and discipline in the enterprise.	Not generally suitable for growth stages. Conditions must be carefully assessed to ensure that debt conditions do not reduce potentials for impact and sustainability.	Requires careful thought and planning to ensure that the risks to the enterprise are minimised and that appropriate investors will be attracted.

24 Extracted from Burkett, I. (2010) *Financing Social Enterprise: Understanding Needs and Realities*, Foresters Community Finance, Melbourne, available online http://www.foresters.org.au/images/stories/publications/financing_social_enterprise_understanding_needs_and_realities.pdf

Appendix II

This appendix (previously tabled at the Senate Inquiry, 1 August 2011) outlines a series of case studies that illustrate the diversity of models and approaches, including some innovative financing mechanisms. These present case studies of supply, demand and also existing initiatives.

Demand for Capital: The Social Business 'Pipeline'

Mission Australia and Social Enterprise

Mission Australia has been involved in establishing and nurturing a series of successful social enterprises. The role of Mission Australia includes hosting, providing capital, providing access to networks, administrative support and access to leadership expertise to enterprises, including:

Soft Landing Mattress Recycling[25]: Soft Landing recycles and refurbishes discarded mattresses and represents an innovative, integrated collaboration of industry, community and government (including funding from the Department of Education, Employment and Workplace Relations' Jobs Fund). The enterprise aims for financial viability while working towards environmental sustainability, improving access to sustainable employment and education pathways for people in Wollongong.

Charcoal Lane[26]: In 2006, Mission Australia established Charcoal Lane, a high-quality restaurant that provides work experience, hospitality training and supportive environment to enable Aboriginal and disadvantaged young people to transition to mainstream employment. The Charcoal Lane program also includes developing personal skills and accredited education in hospitality. It describes its mission as "reconciliation and understanding through food".

Feather Weight[27]: Soon to be established in Bellambi, NSW, Feather Weight will manufacture punching bags and protective sports equipment, including tackle bags, hit shields and goal post pads. The enterprise will train and employ up to 11 job seekers with disabilities in recycling services, giving them the support they need to achieve accredited training in Certificate II in waste management. The social enterprise has been allocated $600,000 from the federal government's Innovation Fund.

Charitable Bonds: Chris O'Brien Lifehouse at RPA[28]

The Chris O'Brien Lifehouse at RPA will be an integrated cancer centre incorporating patient care and treatment, research and integrative and complementary medicine facilities. A Charitable Bond was developed and proposed in 2010 that aimed to raise $35 million to accelerate the development and construction of this project. The initial offer closed in early December 2010.

Charitable bonds offer a means of investment blending financial, community and social returns. The bond offered by the Chris O'Brien Lifehouse at RPA bond involved a fixed term deposit (6-8 years) of minimum $20,000, which was open to superannuation funds. The bonds offered an interest rate of 5-8 percent paid bi-annually with the project estimated to generate an internal rate of return of 6-6.2 percent over the six to eight year term.

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[25] Information adapted from Soft Landing Website: http://www.softlanding.com.au/

[26] Information adapted from Charcoal Lane Website: http://www.charcoallane.com.au/

[27] http://www.deewr.gov.au/ministers/ellis/media/releases/pages/article_110629_163927.aspx

[28] Information adapted from Chris O'Brien Lifehouse website: http://www.lifehouserpa.org.au/uploadedFiles/Tiles/Text/YAR%20Lifehouse%20Term%20Flyer%20%5BPrint%20v3%5D.pdf

Social Bonds: The Benevolent Society's Apartments for Life[29]

The Apartments for Life[30] proposal offers a new and innovative approach to providing affordable and quality housing, care and support for older people. Based on the successful Humanitas[31] model from the Netherlands, Apartments for Life will offer 128 apartments specifically designed for older people, in two medium-rise buildings and a smaller building in Bondi, NSW. The project features age-friendly design; interaction with the surrounding community; care advice; community support; affordability and community and family interaction. The project is being developed with the aim that 95% of residents will be able to stay in their own apartment until the end of their life, reducing the cost burden of placing older people in hostels or nursing homes and the negative impacts on older people of moving house and losing independence.

A number of options are available to ensure affordability of the apartments to local people from a range of financial circumstances: 10 percent of apartments will be rented to low income older people, and an additional 30 percent of apartments will be offered at discounted prices.

The Benevolent Society is currently formulating a social bond that will assist in raising the start-up capital required for the project, and will offer a modest return to investors. The bond hopes to raise $10 million, providing a 5 percent return per annum. The project is estimated to provide a social benefit valued at $30 million through extending active independent life and avoiding hospitalisations and high level care.

Hepburn Community Wind Park Co-operative[32]

The Hepburn Community Wind Park[33] is Australia's first community owned wind farm. The Hepburn Community Wind Park will be owned and operated by the Hepburn Wind Co-operative Ltd, a community owned co-operative based on the success seen in similar programs in Europe.

Through a share offer, Hepburn Community Wind raised more than $7.5 million from 1,100 co-operative members which, combined with a $3.1 million financing facility from Bendigo Bank and a $975,000 grant from the Victorian Government's Renewable Energy Support Fund. In May 2010 Hepburn issued a further share offer to raise an additional $1.8 million.

The co-operative had nearly 1,700 members as of July 2011, who have contributed more than $8.7 million to build the farm. After raising the required capital, the project is open for investment from Victorian residents; additional capital raised will be used to pay down debt. The Park began generating energy in June 2011.

The co-operative model ensures that control and financial benefits of the Park remain in local hands. It also offers many benefits to the local community. Profits generated from the Park will be distributed annually to the co-operative members and the project will also distribute money annually to fund community programs. Community involvement in the project provides opportunities for developing leadership and organisational skills, for further community education and for encouraging collaborative efforts toward sustainable development.

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[29] Information adapted from http://www.bensoc.org.au/director/whatwedo/olderpeople/oceanstsite.cfm

[30] http://www.bensoc.org.au/director/whatwedo/olderpeople/oceanstsite.cfm

[31] http://www.bensoc.org.au/director/whatwedo/olderpeople/oceanstsite/humanitasfoundation.cfm

[32] Information adapted from the Hepburn Community Wind Park website http://hepburnwind.com.au/

[33] http://hepburnwind.com.au/

West Belconnen Health Co-operative[34]

West Belconnen Health Co-operative Ltd was formed in November 2006 to address community demand for affordable GPs in a disadvantaged area on Canberra's northern fringe. Based on credible business feasibility studies and consultation, the co-operative model was considered the most effective approach to meeting its dual vision: "working together for better health and increased community strength". The co-operative integrates social and economic objectives and provides mutual and democratic control over the enterprise.

Set-up funding for the co-operative was achieved through a community, federal, territory and local business partnership. The co-operative hopes to achieve viability through bulk-billed Medicare rebates, fees for other services and rental income from co-located services.

The Health Co-operative saw rapid growth in membership to 5,500 in November 2010. The co-operative is open in two locations: Charnwood and Totterdell Street, Belconnen.

Family-by-Family[35]

Launched in April 2011 by The Australian Centre for Social Innovation (TACSI), the Family-by-Family model is based on a network of families helping families. The program aims to "reduce the number of families coming into contact with crisis services, and enable more families to thrive". The program takes a unique approach by taking the family as a unit of focus, with whole families being used as primary service deliverers and professionals playing a support role only. Moreover, the approach is generative: the more families that pass through the program successfully, the more resources are available to help other families.

The importance of this project is underlined by the economic and social costs of intervening in families at crisis point. TACSI suggest that alternative care of children can cost up to $150,000 per year and that the long term cost of child abuse and neglect to Australia is $1,944 million per year. For the cost of three children in alternative care each year, the Family by Family project can operate in a local community and work with close to 100 families.

Consultation with key players including 100 families, government (state and local), not-for-profit organisations and academics was incorporated into the initial scoping, design, and prototyping of the project. The funding mix for the project includes that from government, not-for-profits and philanthropic foundations.

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[34] Information adapted from the West Belconnen Health Co-operative website http://www.westbelconnenhealth.coop/

[35] Information adapted from Family-by-Family website http://familybyfamily.org.au/

Supply of Capital

Social Investment: AMP Capital Community Infrastructure Fund[36]

This Fund focuses on providing investors with "the opportunity for stable, long term returns through the investment in an unlisted portfolio of high quality Private-Public Partnership style social infrastructure assets" [37]. The assets focussed on include Private-Public Partnership in the areas of education, health, justice, defence, community housing, recreational facilities, transport and other social infrastructure sectors. Asset income is primarily derived from long term, CPI-linked concession arrangements with government entities.

Social Investment: Christian Super Fund[38]

The Christian Super Fund[39] has a strict mandate to uphold high environmental, social and governance standards in all of its investments (all five of the Fund's superannuation investment options are subject to ethical screening). The fund has around $30 million invested in positive impact assets.

"Although we seek investments with high social value, we also have a fiduciary duty to our members to maximise their financial returns and minimise risk. It is in our interest therefore, that a robust capital market for social economy organisations be developed so that we can mitigate some of the risks currently existing in the sector".

The Fund invests in traditional asset classes where investments are subject to both positive and negative screening: seeking "investment opportunities that provide both strong investment returns and a valuable contribution to society and the environment".

The Fund is also extending its impact investing into non-traditional asset classes, including renewables, microfinance, social infrastructure and sustainable agriculture with other areas under consideration.

Uniting Church of Australia[40]

The Uniting Church of Australia has chosen "to vest primary responsibilities regarding the mission of the Church in the area of national functions in community services to UnitingCare". The Church provides funding and capital to support UnitingCare activities in supporting community services and advocacy for children, young people, families, Indigenous Australians, people with disabilities, people from culturally diverse backgrounds and older Australians in urban, rural and remote communities.

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[36] Information adapted from AMP Capital website: http://www.ampcapital.com.au/institutional-investors/infrastructure/community-infrastructure-fund.asp?_channel=3

[37] http://www.ampcapital.com.au/institutional-investors/infrastructure/community-infrastructure-fund.asp?_channel=3

[38] Information adapted from Christian Super website: http://www.christiansuper.com.au/

[39] http://www.christiansuper.com.au/

[40] http://www.unitingcare.org.au/

National Australia Bank (NAB)

The strategic focus for several of NAB's community programs is promoting financial inclusion. Two programs that form part of this approach include:

StepUP Loan Scheme[41]: StepUP Loans are personal, unsecured loans offered at a basic interest rate for the purchase of essential personal, household and domestic goods and services. The loans are available to individuals and families on low incomes and recipients are mentored by a microcredit worker through the loan process and repayment period. Repayment of a StepUP loan establishes an entry to the mainstream credit system.

No Interest Loan Scheme[42]: This scheme provides no interest loans for people on low incomes for the purchase of essential household goods, and also helps borrowers improve their savings and budgeting skills. Administered by the Good Shepherd Youth & Family Services, the program has recently expanded to target communities experiencing disadvantage. Capital is committed by NAB on an ongoing basis into the program and is then recycled by community-based no interest loan providers.

Microenterprise Loans[43]: This program targets financial exclusion for small enterprises by providing credit to new or existing small businesses (with five or fewer employees) that are not eligible for mainstream finance options. The program involves an unsecured business loan of between $500 and $20,000 and also involves business training, mentoring and skills training.

Westpac Banking Group[44]

In 2010, the Westpac Banking Group[45] entered into a strategic partnership with Parramatta City Council[46] to support social enterprises. Westpac supports and complements government seed funding and investment in social enterprises by linking skilled volunteers who work as business mentors to social enterprises. The program encourages volunteers from the bank to provide their skills and experience to high impact social enterprises, and offers the additional benefit to the bank of improved staff engagement.

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[41] Information adapted from NAB website http://www.nab.com.au/wps/wcm/connect/nab/nab/home/about_us/7/4/3/4

[42] Information adapted from NAB website http://www.nab.com.au/wps/wcm/connect/nab/nab/home/About_Us/7/4/3/3/?ncID=ZBA

[43] Information adapted from NAB website http://www.nab.com.au/wps/wcm/connect/nab/nab/home/About_Us/7/4/3/2/?ncID=ZBA

[44] Information adapted from Westpac website: http://www.westpac.com.au/docs/pdf/aw/Organisational_mentoriing.pdf

[45] http://www.westpac.com.au/

[46] http://www.parracity.nsw.gov.au/

Established programs

Case Study: City of Yarra Street Cleaning Joint Venture[47]

The City of Yarra, a council located in an inner city area of Melbourne, has undertaken some innovative social procurement work over a number of years. Home to a diverse range of people including large numbers of recently arrived migrants and refugees, the City also has a number of high-rise public housing estates that have been the subject of complex social issues over many years. There were three complex and seemingly unrelated issues facing the City of Yarra some years ago:

Problems with some of the public housing high-rise estates: high unemployment, vandalism, drugs and 'few pathways out';

Ageing workforce in council depot (average age of 52 years), recruitment issues, lack of younger applicants for jobs, council forced to pay high costs to use labour hire companies;

Quality issues in the contract for street cleaning (in its final year before re-tender).

The City of Yarra examined these issues in conjunction with a not-for-profit, Brotherhood of St Laurence (BSL), and decided to embark on a joint venture to develop innovative solutions. Council negotiated a variation in the contract with its existing street cleaning supplier that excised particular localities and activities (and the money associated with this) from the existing contract. Council then applied for and was granted an exemption from the Minister for Local Government in Victoria to undertake the joint venture work without tendering for it on the open market. Council entered into a MOU with BSL and put in place extra reporting requirements and greater levels of monitoring/evaluation than for a traditional contract. Under the terms of the MOU, the aim of the joint venture was to:

"develop a street sweeping model that suited the needs of Yarra City Council in terms of both efficiency and outcome;" and

"develop pathways into employment for long-term unemployed residents in the City"

BSL provided the training, traineeship support and funding to operate the transitional labour market social enterprise that was to ensure that the long-term unemployed residents in the identified target group were employed and trained. The council provided key infrastructure, access to the depot, equipment, technical support and advice. The outcomes and benefits:

High quality street cleaning service.

Opportunity to diversify council workforce and to establish a pathway to employment for young people from the estate through traineeships.

Positive impact for employed residents and for the estate residents as a whole – less fighting, vandalism, drugs and improved perception of estate residents from other residents.

Cost savings for council in the long-term – no more need for continued use of expensive labour hire companies, solving of recruitment problems, less vandalism on the estate, less drug use. Although there were some increased costs to start with (more active engagement in the work than would be in a traditional contract), the long-term and broad benefits far outweigh these costs.

Contribution to building a more diverse supply market in the nearly-monopolistic local area.

[47] http://www.socialtraders.com.au/social-procurement-case-study-yarra-city-councils-street-cleaning-contract

Charitable Consortium: GoodStart Childcare Limited[48]

GoodStart Childcare Limited[49] is a charitable consortium formed by some of Australia's leading and most respected not-for-profit organisations: Mission Australia, The Benevolent Society, the Brotherhood of St Laurence and Social Ventures Australia. Its vision is "for Australia's children to have the best possible start in life through the provision of high quality, accessible, community-connected early learning and care".

In 2009, the GoodStart consortium purchased 678 childcare centres from the failed ABC Learning. The funding that supported this purchase includes a Commonwealth Government loan and tax concessions, a financing arrangement (including senior debt) from the National Australia Bank, 'social notes' from private investors as well as deeply subordinated debt from foundation partners.

Impact Investing: National Rental Affordability Scheme (NRAS)[50]

In response to poor housing affordability, the NRAS[51] was created in 2008 and represents a supply-side intervention to encourage the construction of affordable rental properties. Tax credits or cash payments are provided over 10 years to investors providing affordable housing, which is provided to residents at a minimum of 20 percent below the market rate. In practice, nearly all NRAS properties are managed by not-for-profit housing providers, where the credit is provided as an equivalent cash payment. Among not-for-profit providers, rents are often at least 25 percent below the market rate (partly due to satisfy charitable tax law requirements).

A review[52] of the program in 2010 concluded that the number of affordable rental homes in Australia increased and the standard residential net income return for not-for-profit housing providers increased from 2 to 5 percent. The review found that the program was initially funded to support 50,000 new homes, however is expected to eventually expand to twice this figure. Nonetheless, the review found that the program was considered less successful in targeting Australia's most unaffordable markets and failed to attract the interest of institutional investors who required more aggregation, liquidity and clear risk profiling.

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48 Information adapted from GoodStart Childcare website: http://www.childcare.com.au/

49 http://www.childcare.com.au/

50 Information adapted from that in Wood, D. & Thornley, B. (2011) *Impact Investing: A Framework for Policy Design and Analysis*, Pacific Community Ventures, San Francisco.

51 http://www.environment.gov.au/housing/nras/index.html

52 Wood, D. & Thornley, B. (2011) *Impact Investing: A Framework for Policy Design and Analysis*, Pacific Community Ventures, San Francisco.

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