

20 September 2011

Dear Senator,

**RE: Senate Economics References Committee enquiry into mechanisms for developing a robust capital market for social economy organisations**

The Cape York Institute for Policy and Leadership (CYI) welcomes the opportunity to provide a submission in response to this inquiry. CYI was established in July 2004 as an independent policy and leadership organisation that champions reform in Indigenous economic and social policies and supports the development of current and future Cape York leaders.

In 2000, in 'Our Right To Take Responsibility', I drew attention to the devastating impact of passive welfare on Indigenous families and communities. Welfare reform aims to remove welfare dependency and *to ensure that Cape York people have the capabilities to choose a life they have reason to value* – this is the Cape York Agenda. This agenda requires economic and social development, as well as expanding the choices available to people. However, choice is only possible when individual and group capabilities are in place, in areas such as education, health and community.

The Cape York not-for-profit (NFP) sector works across the spectrum of education, health, housing, employment and social support, from service delivery to economic and social development. While appropriate levels and structures of financial resources are critical to success, access to finance is not the most pressing barrier in the Cape York context.

Changing the way we resource the NFP sector to encourage innovation is the critical challenge. Building capabilities and expanding economic and social choices requires innovation and commitment; pouring money blindly into existing services and welfare has failed. A sustained commitment to people, not just projects, will allow us to build an environment where new ideas can be robustly explored, tested, and selected on merit. Those ideas that work will then need access to broader investment. We recommend that up to 20 percent of current Australian Indigenous service delivery spend should be committed to innovation in line with the risk and potential social impact of success in this space.

Building a broader understanding of social impact is crucial. Quantifying outcomes will be an important component; evaluation techniques that measure efficacy and not just delivery will need to be developed. However, this also requires a shift in thinking. Government has the opportunity to lead this shift through the areas that it supports and the "rules of the game" that it establishes.

We therefore welcome this inquiry into mechanisms for developing a robust capital market for social economies. While access to capital markets is not our immediate focus, the extent to which



this process encourages innovation and supports capability development within the sector will lead to improved outcomes. It also establishes a platform for our future success.

A submission that further explores these ideas is attached to this letter. This document:

- Describes the background and challenges in the Cape York NFP sector
- Discusses some of the proposed models and suggestions made in both the Productivity Commissions report and other submissions to the Senate Economics References Committee
- Explores Cape York specific considerations in the development of any potential mechanisms for developing a market for social economy organisations.

Please contact us should you require more information.

Regards

Noel Pearson



# Submission to the Senate Economics References Committee enquiring into mechanisms and options for developing a robust capital market for social economy organisations

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## **1. Current state of the Cape York Indigenous NFP Sector**

Cape York is home to some of Australia's most disadvantaged people. The myriad of not-for-profit (NFP) organisations, Social Enterprises (SE) and Social Businesses (SB) that operate across the Cape are united in their objective to alleviate this disadvantage. However the sector is not operating at its optimal potential because it is:

- fragmented;
- not financially sustainable; and
- at an early stage developmentally.

### **1.1. A highly fragmented market**

Both the region and the social impact organisations servicing Cape York are fragmented. Cape York is extremely heterogeneous, reflecting:

- 17 discrete villages with permanent populations of up to 1500 people;
- local languages and culture; and
- a community diaspora that lives in Cape York regional towns and more broadly around Australia and the world.

The remoteness, diversity of local contexts and environment, and importance of relationships underscores the need for locally owned and derived programs wherever feasible and appropriate.

These diverse communities are supported by a vast portfolio of programs that differ in objectives and approaches. These programs cover the spectrum of community needs and can be segmented into five broad areas:

1. Service provision
2. Capability building
3. Social development
4. Economic development
5. Infrastructure development

Cape York Regional Organisations (CYROs) operate as social impact intermediaries to support this portfolio of broader programs.

### **1.2. Business models are not designed for financial sustainability**

Current Cape York NFP activities focus primarily on:

- improving Government service provision; and
- capability building and social development initiatives.

Their objectives are primarily social and given appropriate service contracts these programs aim to achieve operational sustainability. They may deliver efficiencies for government; however, the goal



is improved program efficacy rather than economic return. In addition, fragmentation and limited opportunity for scale means that any efficiencies will be difficult to capture and financial returns are unlikely in the short to medium term.

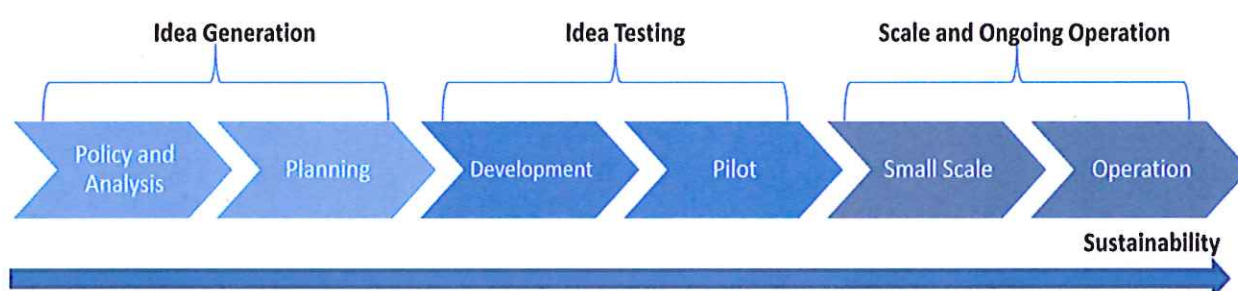
While the CYROs understand that the path to social viability is highly dependent on economic viability, very few independent sustainable SE and SBs exist. This is reflected in the limited private economic and infrastructure development activity<sup>1</sup> across Cape York, a state of affairs which is unlikely to change in the absence of land reform to enable secure and transferable title on Indigenous land. Current models rely very heavily on Government funding or are Government sponsored enterprises. Where private economic and infrastructure initiatives do exist, the business model primarily reflects a social return and any notional profits are typically reinvested into either community or family.

Welfare Reform has demonstrated the potential for sustainable non-Government SEs and SBs; improving the prospect for a viable economy in the future that is independent of the extraordinary government transfers that currently define the economy.

### 1.3. Defined by early stage development

With a few notable exceptions<sup>2</sup>, most programs are still in the early stages of development, even when the organisations supporting their delivery are more mature. This sector typifies an early investment and “commercialisation”<sup>3</sup> model (fig 1.0), rather than a business evolution model; with a large number of competing early stage projects, a number of pilots and few scaled programs.

**Fig1.0 Social investment and commercialisation model**



<sup>1</sup> Income transfers (including CDEP) accounts for approximately 70% of the total community income in remote communities. Internal Cape York Institute analysis and ABS Catalogue 1379.0.55.001.

<sup>2</sup> For example CYI's Higher Expectations Program has been running successfully since 2005.

<sup>3</sup> One of the key characteristics of this “commercialisation” model is that different stages of idea development and implementation are often done by different organisations while the idea flows through the organisations. Eg Universities (Idea Generation) > Biotech companies (Idea testing) > Pharma Companies (Scale and Operation)

Most current activity is focussed on the development, pilot and small scale phases. More mature intermediaries, such as Cape York Partnerships (CYP) and Balkanu, exist to enable solutions to be derived and delivered locally by the communities themselves.

The CYROs are acutely aware of the important challenge of balancing the efficiencies that scale can bring with the need for a community specific response. The intermediary model, utilised by CYP and others, has been shown to be effective. The model reflects the importance of relationships, while providing some efficiencies of scale and organisational learning. However, the sector in Cape York in general does not lend itself easily to scaling up of programs.

A limited number of more mature organisations are responsible for the ongoing operation of programs. These organisations currently play a larger role in specific communities on the Cape but do not yet operate in all Cape York communities.

CYROs have over time developed a much more robust and organised approach to innovation; generating ideas and supporting policy development as a mechanism to drive change and build support for their approach. A significant challenge for further improvements in this area is accessing core funding for this critical phase of work.



## **2. Financial resources used by the Cape York NFP sector**

### ***Inquiry terms of reference “finance and credit options available to the sector”***

In general, financial resources can come from funding (eg; grants, donations) with no expectation of repayment or financing (eg; debt, equity) which has an expectation of repayment and typically a return. Currently many NFPs operating in Cape York rely on one-off grants and short term funding. This type of funding is a poor natural fit for many of the sector’s programs and is limiting their effectiveness.

#### **2.1. Reliance on funding**

Many NFPs operating in Cape York rely on government funding. As Government seeks to outsource specific services, financial resourcing is more often available for the provision of essential services, for example, Apunipima Cape York Health Council (Apunipima) delivers primary health and public health initiatives in many Cape York communities. Long term funding contracts are generally supplemented by Government and philanthropic project grants.

Debt and credit are currently not often used in the sector and without secure and measurable revenue streams this type of financing is neither accessible nor appropriate. This situation is likely to rapidly change as enterprises and businesses mature or if organisations can establish the financial security that is necessary to demonstrate credit worthiness.

Complex financing would only be appropriate for limited infrastructure projects. With the exception of Welfare Reform, current Cape York projects and social enterprises neither:

- are at a stage where complex financial structures are appropriate;
- have the scale to justify them;
- have the expectations of measurable financial returns;
- have the capabilities to utilise them effectively; nor
- operate in an environment in which secure and transferable title to land is available.

Even where simple financial instruments, such as a bank loan, are appropriate, organisations operating within the sector can lack the skills and understanding to use them effectively. For example, many small businesses in Cape York struggle with the daily tasks required to start and operate a business, such as submitting BAS and GST statements. In some cases, the underlying cause is simply that the people with the ideas do not have adequate literacy and numeracy skills.

#### **2.2. Challenges with current financial resourcing**

There is often a disconnect between financial need and what financial resources are available. The result is a misalignment of incentives and inefficiencies, where the availability of resources is the primary determinant of how activities are prioritised rather than the objective needs of the sector.

### **2.2.1. Misalignment of financial resources**

The contrast between the relative ease of getting contracts for service delivery and the extreme difficulty of getting core funding for innovation is currently driving the NFP sector and limiting its effectiveness and potential. There can be significant pressure to divert funding away from planning, testing or evaluating programs into immediate scale in order to secure resourcing. In addition, small programs often have insufficient time or capacity within the funding term, to identify and secure appropriate skills to ensure program delivery, limiting their effectiveness. The result is organisations that are stretched to deliver programs that are not rigorously planned and tested.

### **2.2.2. The costs of short term commitments**

Short term grants and service contracts limit organisational security, reduce growth and maturation of the sector. They do not provide opportunities to fund corporate operations or develop organisational capability. Organisations cannot offer specialised staff long term roles which can result in a mismatch of skills with program needs and increase the risk of high employee turnover. High turnover and the loss of organisational knowledge result in organisations that are constantly “making do”.

Short term funding commitments result in lack of relationship development and program consistency. They can curtail program testing in the rush to implementation during the funding term. Even when programs are well defined, this combination limits the efficacy of the immediate program and risks the credibility of the next.

Cape York Indigenous communities have seen a parade of programs over the years, each promising improvements. The cycle of over-promising and under-delivering has led to a deep and justified sense of caution for Cape York people. This, combined with the challenges of understanding local contexts and relationships, means that the NFP sector on Cape York must be defined by long term relationships and commitments. The costs associated with short term funding are not easy to measure and analyse. Certainly there are transaction costs (see below) but more important are the opportunity costs associated with continuing this pattern.

### **2.2.3. Focused on outputs not outcomes**

Government and philanthropic organisations are often risk averse in nature, particularly in such an uncertain environment as Cape York. Substantial reporting requirements are used as a risk mitigation strategy; typically relating to project delivery and organisational management.

The reliance on output success measures leads to a focus on delivery not efficacy. This is a false economy. Innovation is stifled in this environment where lack of success is seen as failure and not successful learning. There is limited incentive to build improvements in rigour and evaluation of social impact or outcomes and programs are reduced to the lowest common denominator.



#### **2.2.4. Characterised by significant transaction costs**

The current resourcing model includes significant transaction costs which are inappropriately high given the scale and scope of programs across the Cape. These include:

- significant investment in relationship development;
- lengthy and time consuming application processes;
- multiple non-standard contracts typically designed for large scale delivery; and
- significant reporting requirements.

Some emerging organisations have neither the resources nor the capabilities to overcome these hurdles. Many good ideas and people are stifled entirely. Where organisations can, they spend an inordinate amount of time and resources meeting these requirements; time, effort and money that would be better spent on their core business.

### 3. What are the financial needs of the Sector?

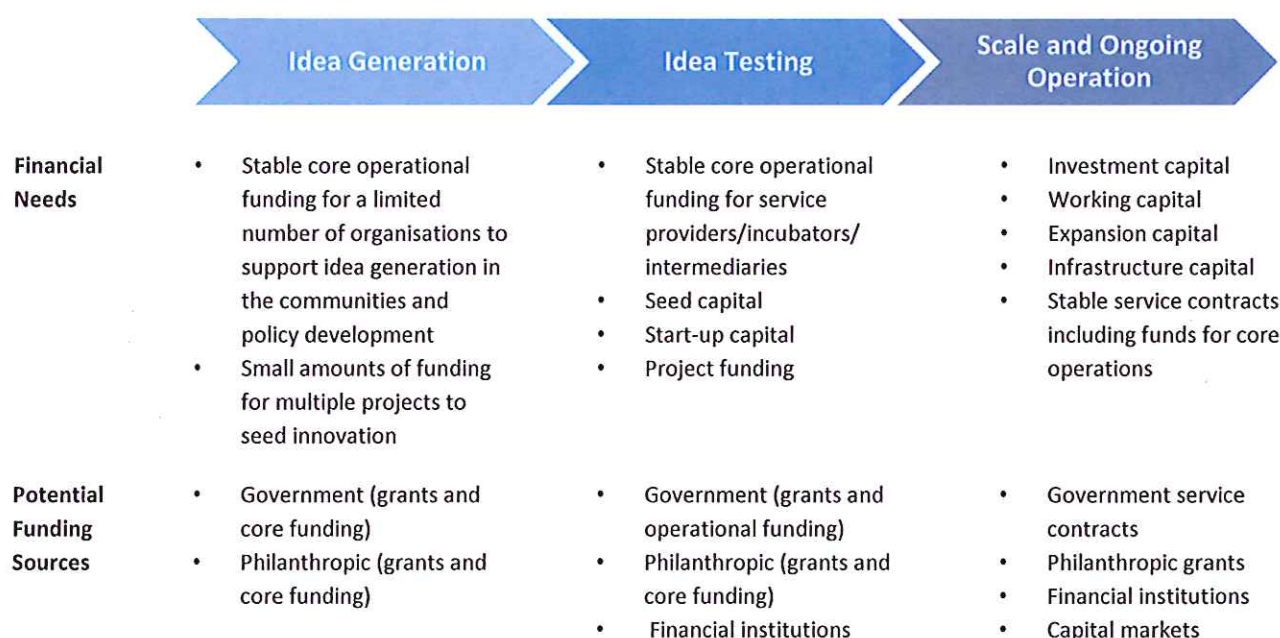
#### *Inquiry terms of reference "financial needs of the sector"*

**Recommendation 3.0:** Funding gaps exist in Idea Generation and Idea Testing phases, which is critical to the success of the Welfare Reform and the Cape York Agenda. This requires:

- Core operational funding
- Focus on achievement of long term outcomes.

Financial requirements differ across the sector according to segment, approach and the maturity of the program. However, in general the types of funding required are summarised in Figure 2.0.

**Figure 2.0 Financial needs of the sector**



Currently there is a significant gap in core funding for the Idea Generation and Idea Testing stages. There is natural pressure for the resources that are needed to undertake and support this work to be found through cross-subsidisation from service delivery income (see 2.2.1). Funders are, quite reasonably, tightening the terms of their contracts to minimise that cross-subsidisation. However, if this funding source is closed without being replaced, the longer term development of the sector will put at risk.

Funding for core operations, a component of core funding, is essential to allow investment in idea generation, sustained commitment to people and program planning. In particular, the ability to invest in our people and their capability development is core to the success of Welfare Reform and the Cape York agenda.

Funding for corporate operations, the other component of core funding, is not just about overheads that should be minimised, but also represents valuable functions including:



- organisational memory and knowledge;
- inter organisational knowledge transfer; and
- relationship development.

As one example, The Cape York Aboriginal Australian Academy gets weekly requests from people who want to see the Aurukun School to better understand the broad education approach and student case management process. This effort requires considerable time and resources, and is very valuable for idea sharing and the development of the broader Indigenous and non-Indigenous education sectors. The fact that these visits are an unfunded activity means that money must be sourced from elsewhere; establishing a tension between supporting schools and knowledge transfer.

## 4. Improving access to finance for the Cape York NFP Sector

### 4.1. Opening the sector up to outside investment

**Recommendation 4.1:** The Government should take a lead role in the development of a market for social economy organisations. This should include:

- Aligning the tax, legal and regulatory environment to incentivise diverse sector investment; and
- Development of tools and process to enable measurement and capture of return.

Finance is unlikely to be a core component of the Cape York NFP sector resourcing in the near term. However, we support the development of a social market economy for all Australian NFPs and anticipate that the Cape York sector will also benefit indirectly in the short term as well as establishing a longer term platform for future success.

Opening the sector to private investment is essential. This will increase the funds available, diversify risk and allow leverage of current Government and philanthropic funding. Encouraging diversification of resourcing of the sector and the corresponding capability development will encourage:

- efficiency and effectiveness in financing;
- evaluation, monitoring and measurement of social return;
- risk management rather than risk aversion;
- governance, transparency and accountability.

Government must support this development by aligning the legal, tax and regulatory structures to incentivise investment. The current scale and scope of the Australian sector means that Government also has a role to play in supporting the development of tools to capture and measure social return, essential to improve the investment attractiveness of the sector and its programs.

### 4.2. Additional resources to consider as part of the framework

**Recommendation 4.2:** Corporate Social Responsibility should be further investigated as a source for resourcing social impact organisations, particularly in the Cape York sector.

When frameworks for broader investment are being established Corporate Social Responsibility should be considered as an additional source of resourcing.

Corporate Social Responsibility initiatives are substantial contributors to the Australian NFP sector. While this is not always in the form of financial investment, it is a very important component in the mix of overall resourcing. For example; Jawun supports corporate partnerships across Cape York as well as the East Kimberly region, Shepparton and Redfern. These partners provide skills, knowledge, resources and improve access to the funds. Therefore, harnessing the latent potential present in the corporate sector must be part of any structured solution.



### 4.3. Social Impact Bonds

#### *Inquiry terms of reference “potential role of Social Impact Bonds”*

**Recommendation 4.3:** Social Impact Bonds are not an appropriate vehicle to build investment in the Cape York sector at this stage.

Social Impact Bonds (SIB) are designed to facilitate investment in Government service provision. To date they have been used in the UK for a single program – a prisoner rehabilitation program on a “return for success” basis. This model relies on the social impact program delivering sufficient efficiencies in the prison system, by keeping prisoners out of the prisons, to generate financial savings which will fund a return for investors. Effectively the primary outcome is shift in risk as there is no new money involved.

While the model is receiving significant interest and public attention, it does have significant limitations.

- SIBs are complex instruments with substantial transaction costs.
- SIBs require clearly defined and measurable outcomes.
- SIBs rely on scale to generate sufficient efficiencies to fund investment return.

Funding of Government service provision, social impact programs, or economic development projects across the Cape with SIBs or similar instruments is not likely to be attractive in the near future. This is due the stage of program development, market fragmentation and the difficulties in measuring outcomes in a complex social and economic environment.

Balkanu has investigated the potential for “bonds” to fund economic development projects across the Cape and has been advised against their use.

### 4.4. Investment in capability development is required

**Recommendation 4.4 a:** Increasing investment in the sector needs to be supported by capability development to allow:

- Effective and efficient use of finance;
- Improved business rigour in organisational development and operation.

**Recommendation 4.4 b:** The configuration and membership of NFP boards must be aligned with the needs of the organisation. Support is required for:

- Developing governance arrangements that address NFP’s needs;
- Building alignment of independent director’s incentives; and
- Recruiting appropriate board members with the commitment, skills and knowledge.

Building access to financial markets is not sufficient as some parts of the Cape York NFP sector are not investment ready. The sector has been characterised by failures when:

- incentives are not carefully aligned;
- capability to understand and use finance is not in place; or
- financial mechanisms are not appropriate for the type of project or developmental stage.

Investment in capability development and business rigour should be immediate priorities. Effective use of financial instruments and mechanisms requires:

- an understanding of and tolerance for risk; and
- a high degree of financial capability.

Investment in demand side capability is *in itself* a social impact investment, particularly when the people involved are Indigenous, local or have long term links to the region. Improvements in business rigour, diversification of business models and broader capability development will in effect build the level of professionalization of the sector. This will in turn enhance the investment attractiveness of the sector.

Investment attractiveness and readiness depends on the capabilities of frontline, management and boards. The configuration and membership of NFP board's must be aligned with the needs of the organisation. Support is required for the:

- development of governance arrangements that address NFP's needs;
- building alignment of independent director's incentives; and
- recruiting appropriate board members with the commitment, skills and knowledge.

In addition, enhancing the capabilities of boards and management within the sector will be important. A comprehensive strategy should include:

- mentoring programs for current NFP board members and management;
- education programs for current and potential Indigenous NFP board members; and
- leadership development programs for potential NFP leaders.

The operation and programs of the CYROs, in particular CYI and CYP, provide some good examples of these types of activities and the benefits that they can generate. Examples include the structure and operation of CYRO Boards and the Leadership Academy program that is operated by CYI.

#### **4.5. The use of intermediaries**

*Inquiry terms of reference "the role of financial intermediaries."*

**Recommendation 4.5:** Development of a wholesale financial intermediary may be effective in attracting broader investment in Australian social impact organisations and enhancing access to capital markets. However, as access to finance and capital markets is not an immediate barrier in the Cape York sector, their role in financing the Cape York NFP sector is likely to be limited for the foreseeable future.



A wholesale financial intermediary may be an appropriate mechanism to attract increased and diversified investment. As with UK Big Society Capital<sup>4</sup>, the entity will need to address capability development on both the supply and demand side, particularly in risk management. However, as access to finance and capital markets is not an immediate barrier in the Cape York sector, their role in financing the Cape York NFP sector is likely to be limited for the foreseeable future.

Enhancing investment attractiveness of Cape York NFP sector will require both increased scale and corporatisation of the sector. An intermediary with sector specific capabilities could be well placed to achieve this by:

- building scale, potentially through bundling (across programs or within regions);
- standardising contractual arrangements and reducing transaction costs;
- standardising investment criteria;
- developing sector specific evaluation and monitoring standards; and
- supporting and rewarding improvements in governance and accountability.

A series of sector specific 'general' intermediaries could supplement a wholesale financial intermediary, such as the Forester Community Finance's model<sup>5</sup>. Under this model, an Indigenous Intermediary would work to build relationships across the Cape York sector and have specific indigenous knowledge. An Indigenous Intermediary would most likely need to be a new entity in order to maintain transparency and independence around investment decisions.

Arguably the challenge with any intermediary model is to balance specificity with operational efficiency. The sector does not need greater levels of bureaucracy but rather improved access to financing.

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<sup>4</sup> Big Society Bank Outline Proposal May 2011 sourced <http://www.bigsocietycapital.com/pdfs/Outline%20Proposal.pdf>

<sup>5</sup> Foresters Community Finance p42, Figure 13: Different Roles and Relationships for Mainstream Financial Institutions in a Not-for-Profit Capital Market

#### 4.6. Potential for an investment intermediary

##### *terms of reference “Social Enterprise Development and Investment Funds”(SEDIF)*

**Recommendation 4.6:** The Government should investigate the potential for a Social Investment Fund to fund early stage social impact programs that do not derive their income from trade.

Given that most CYROs require funding to develop programs to the point that they can be contracted to Government, a pre-seed investment fund or incubator model should be considered. While the current SEDIF model currently invests in innovation and supports capability development, it has neither the mandate nor the scale to support social impact programs that do not *“derive a substantial portion of their income from trade and reinvest the majority of their profit/surplus in the fulfilment of their mission.”*<sup>6</sup>

A broader Social Investment Fund could play a similar role for all social impact programs. This could be a philanthropic type model that supports program development and directs investment of grants and donations, such as the Venture Philanthropy Company<sup>7</sup>. Alternatively it could be an expansion of the current SEDIF model to enable investment in social impact programs whose business model allows for sustainability. This increase in scope would naturally require a substantial increase in funds.

For many of the current NFP operating in Cape York to access increased investment, they would first need to agree with government on a “contract service delivery” model such as the operating framework used by Ingeus<sup>8</sup>. Such a model could work by placing a value on future contracts from Government service delivery as a predictable revenue stream and could:

- ensure a sustainable model for many of the CY NFP organisations; and
- enhance their financial viability and attractiveness for finance or potential investment.

<sup>6</sup> <http://www.deewr.gov.au/Employment/Programs/SocialInnovation/SocialEnterprise/Pages/SEDIFFAQs.aspx>

<sup>7</sup> <http://www.theventurephilanthropycompany.org/>

<sup>8</sup> [http://www.ingeus.com.au/pages/leading\\_ideas/84/welfare\\_to\\_work\\_reform\\_public\\_private\\_partnerships.html](http://www.ingeus.com.au/pages/leading_ideas/84/welfare_to_work_reform_public_private_partnerships.html)



## 5. Considerations when developing a market for social economy organisations

### 5.1. Encouraging innovation will lead to genuine outcomes

**Recommendation 5.1:** Government should fund the robust development, planning, testing and evaluation of social impact programs within a framework of innovation that allows for learning and leads to selection of programs that will deliver genuine outcomes. Up to 20 percent of current Australian Indigenous service delivery spend should be committed to innovation in line with the risk and potential social impact of success in this space.

Innovation is the key to our success. Pouring money blindly into existing services and welfare has not and will not work. It is only through the generation of a sustainable economy combined with new ideas and approaches to service delivery, designed and planned well, that it will be possible to achieve significant improvement for Indigenous families.

Innovation occurs where there is a clear focus on outcomes and the freedom to learn. Ideas must be robustly explored and tested, then selected on merit. This needs security and continuity. Governments are the direct users of innovative ideas and policy and should therefore be responsible for resourcing this. While successful programs may generate financial returns and efficiencies, innovation itself needs to be funded. Funding should provide core ongoing stability to allow staff retention and capability development (see section 3).

Corporations in high risk, high yield environments, such as big pharmaceutical and technology companies, allocate up to 20 percent<sup>9</sup> of their budget to research and development. Investment in innovation should be aligned to the risk and potential impact. We would recommend that up to 20 percent of the current investment in Indigenous service delivery across Australia be allocated to innovation.

### 5.2. Lengthen contracts to allow investment capacity and capability

**Recommendation 5.2:** The duration of Government contracts should be aligned with the program objectives and should, in general, be renewable for at least 5 years, providing continuity for capacity development and allowing commitment to people. This should be balanced with appropriate reporting requirements to ensure accountability and risk management.

Capacity and capability development are required to ensure success in our objectives. This requires a commitment to people that will ensure the development of capabilities, improve staff retention

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<sup>9</sup> Novartis R&D budget was around 20% of pharma sales in 2010. Novartis CEO plans to keep China R&D ops in-house - FierceBiotech  
<http://www.fiercebiotech.com/story/novartis-ceo-plans-keep-china-r-d-ops-house/2010-04-29#ixzz1XmzcqVSH>



and enable the development of organisational knowledge. Investment needs to be secure over a period of time and may not immediately or directly generate social or financial return.

In addition, skills are often found through partnerships, for example Jawun supports corporate partnerships across the Cape. Developing these partnerships and making them effective, requires a consistent and long term effort. It took nearly two years and a team of experts to fully develop the planning for Welfare Reform. Both government and the private sector supported this effort through Jawun and provided access to their people via secondments. They would not have done so if they did not believe that the organisation behind Welfare Reform (CYI) was going to be around for the long term.

The duration of Government and philanthropic contracts and grants should be aligned with objectives. Components of Welfare Reform are likely to take a generation to show significant results but specific programs, such as for education, are already demonstrating excellent results. Most contracts should be for at least 5 years; for example 3 years with 2 year potential extension.

These contracts should be implemented with appropriate levels of accountability. Performance and reporting requirements should align incentives and support governance. This will ensure that successful programs are rewarded and allow investors to manage risk. This does not necessarily have to be purely new money, but rather an alignment of current resourcing to deliver win-win outcomes.

### **5.3. Success in Cape York requires rebuilding trust**

**Recommendation 5.3:** Investing in relationships to rebuild trust must be part of the investment proposition for all investors including Government.

Development solutions need to be owned and implemented locally. Across the Cape York a vast number of top down interventions have established a high level of caution and distrust. Success is therefore framed by the relationships and the ability to rebuild trust to deliver outcomes.

Currently large Government departments struggle to manage these relationships consistently and effectively. These relationships are the critical path to learning and broader engagement for both parties. Any structures used to improve NFP access to finance, particularly the use of intermediaries, should continue to provide sufficient opportunity and support for direct investor engagement.

For example, Jawun and the CYROs bring corporate and Indigenous leaders together to share their skills and knowledge to create real change. This engagement facilitates rigorous program development, improved outcomes, alignment of objectives and creates an environment of mutual understanding and respect.

### **5.4. Devolution of responsibility and risk will need to have corresponding rewards**

**Recommendation 5.4:** Returns should reflect the market value of risk under the new financial framework and should be integrated into future Government service contracts.



The development of a social economy should not be about the devolution of Government responsibility or 'risk shifting'. Nor should it be purely about driving corporatisation and efficiencies in the sector. The challenge is to develop the systems and relationships that will enable social impact organisations to access broader investment and build financial security.

Outsourcing service provision simply shifts delivery and outcome risk from Government to the provider. A social economy should price this risk appropriately. Should investors undertake the risk, there will need to be a corresponding market -determined reward. This is not so that the organisation can make a "profit" but so that they can have a reasonable expectation of being able to deliver across a range of inherently risky activities, where those that succeed should compensate for those that do not. Where markets determine the risk is too large for essential services or public goods, then the social investment remains the responsibility of the Government. Additionally, tax structures and service contracts should allow for any operational surpluses under this approach to be considered payment for risk and reinvested into the organisation without penalty.

#### **5.5. Outcomes should be the focus and not input-output management**

**Recommendation 5.5:** Alignment of incentives to reward outcomes is critical and should improve flexibility in decision making. Within this framework the NFP sector has the responsibility to improve accountability and build investor confidence.

Success should be defined by improvements in social outcomes and requires flexibility to adapt to highly localised needs. Contractual arrangements need to focus on outcomes, not delivery, and incorporate broader autonomy and flexibility to enable programs to be tailored to local needs.

This requires a joint effort from both investors and the NFP sector operating both in Cape York and more broadly. Clearly articulating the decision-making processes and frameworks will help build investor confidence. The NFP sector will also need to improve levels of governance and accountability.

In turn, a greater degree of decision making autonomy is essential. This will need to be combined with a focus on measurable objectives and re-alignment of incentives for delivering outcomes and not just service outputs.

For example, for Apunipima this means measuring and rewarding a reduced incidence of high blood pressure in communities and not just the number of health checks. The current Medicare item system rewards the number of health checks irrespective of whether they make any difference to health. The details of how you achieve this will differ from community to community; as long as it is done within an agreed framework, rewards and payments should support improvements in outcome.

## 5.6. Reduce transaction costs

**Recommendation 5.6:** Transaction costs need to be reduced for Cape York NFP organisations to have equitable access to finance and funding. Any approach should address the standardisation of:

- application processes;
- investment criteria;
- contractual arrangements; and
- reporting requirements.

Centralised development of financial instruments and measurement tools will also be critical.

Reducing transaction costs is essential to improving use and access to finance and funding. The process of identifying funding opportunities through to application and contractual processes takes a significant proportion of many organisation's time and resources. A component of a strategy to reduce transaction costs should include standardising the:

- application processes;
- investment criteria;
- contractual arrangements; and
- reporting requirements.

For this standardisation to be effective it will require mutual engagement and capability development of both the sector and any funder or intermediary body. This broader engagement will itself create efficiencies and is critical to the ongoing sector development.

Centralised development of industry specific investment instruments, rating mechanisms and evaluation tools will further support the reduction in transaction costs and improve outcomes. Many organisations currently have neither the capacity nor capability to deliver these. A financial intermediary could support this development.

## 5.7. Policy, Practices and Strategies that affect financial viability

Social norms and capabilities are foundational to establishing a real economy. Whether they are social impact enterprises, or social businesses, a vision of a better social and economic future and the drive to achieve this is essential. Without this, no matter how much support is in place, it is difficult to sustain project development. It is not until individuals and families can all see a better future and the latent social norms and discipline, that are currently present in indigenous communities, are realised, that social enterprises and businesses will have the opportunity to thrive in any scale. Re-establishing social norms, land reform to enable secure and transferable title to Indigenous land, and building a healthy educated society will enable the development of social and economic viability for Cape York families.



## 6. Summary Recommendations

**Recommendation 3.0:** Funding gaps exist in Idea Generation and Idea Testing phases, which is critical to the success of the Welfare Reform and the Cape York Agenda. This requires:

- Core operational funding
- Focus on achievement of long term outcomes.

**Recommendation 4.1:** The Government should take a lead role in the development of a market for social economy organisations. This should include:

- Aligning the tax, legal and regulatory environment to incentivise diverse sector investment; and
- Development of tools and process to enable measurement and capture of return.

**Recommendation 4.2:** Corporate Social Responsibility should be further investigated as a source for resourcing social impact organisations, particularly in the Cape York sector.

**Recommendation 4.3:** Social Impact Bonds are not an appropriate vehicle to build investment in the Cape York sector at this stage.

**Recommendation 4.4 a:** Increasing investment in the sector needs to be supported by capability development to allow:

- Effective and efficient use of finance;
- Improved business rigour in organisational development and operation.

**Recommendation 4.4 b:** The configuration and membership of a board needs to be aligned with the needs of the organisation. Support is required for:

- Developing governance arrangements that address NFP's needs;
- Building alignment of independent director's incentives; and
- Recruiting appropriate board members with the commitment, skills and knowledge.

**Recommendation 4.5:** Development of a wholesale financial intermediary may be effective in attracting broader investment in Australian social impact organisations and enhancing access to capital markets. However, as access to finance and capital markets is not an immediate barrier in the Cape York sector, their role in financing the Cape York NFP sector is likely to be limited for the foreseeable future.

**Recommendation 4.6:** The Government should investigate the potential for a Social Investment Fund to fund early stage social impact programs that do not derive their income from trade.

**Recommendation 5.1:** Government should fund the robust development, planning, testing and evaluation of social impact programs within a framework of innovation that allows for learning and leads to selection of programs that will deliver genuine outcomes. Up to 20 percent of current Australian Indigenous service

delivery spend should be committed to innovation in line with the risk and potential social impact of success in this space.

**Recommendation 5.2:** The duration of Government contracts should be aligned with the program objectives and should, in general, be renewable for at least 5 years, providing continuity for capacity development and allowing commitment to people. This should be balanced with appropriate reporting requirements to ensure accountability and risk management.

**Recommendation 5.3:** Investing in relationships to rebuild trust must be part of the investment proposition for all investors including Government.

**Recommendation 5.4:** Returns should reflect the market value of risk under the new financial framework and should be integrated into future Government service contracts.

**Recommendation 5.5:** Alignment of incentives to reward outcomes is critical and should improve flexibility in decision making. Within this framework the NFP sector has the responsibility to improve accountability and build investor confidence.

**Recommendation 5.6:** Transaction costs need to be reduced for Cape York NFP organisations to have equitable access to finance and funding. Any approach should address the standardisation of:

- application processes;
- investment criteria;
- contractual arrangements; and
- reporting requirements.

Centralised development of financial instruments and measurement tools will also be critical.



## 7. Appendix I – Sample Cape York Social Organisations and Businesses

<b>Apunipima Cape York Health Council</b>  <a href="http://www.apunipima.org.au/">http://www.apunipima.org.au/</a>	<p>Apunipima Cape York Health Council is a primary health care service provider and lead agency representing a holistic approach to health issues in the Cape York Region with the aim <i>to support Cape York communities own solutions to live long healthy lives, strengthening our culture and regaining our spirit.</i></p>
<b>Balkanu Cape York Development Corporation</b>  <a href="http://balkanu.com.au/">http://balkanu.com.au/</a>	<p>Balkanu is committed to supporting the Aboriginal people of Cape York to improve the region's economic and social structures, at the same time as preserving the Aboriginal heritage and culture</p>
<b>The Bama Way</b>  <a href="http://www.bamaway.com.au/">http://www.bamaway.com.au/</a>	<p>The Bama Way is an Aboriginal journey from Cairns to north of Cooktown, following story-lines through the two Aboriginal nations of the Kuku Yalanji and Guugu Yimithirr peoples. The Bama Way is a tourism business that links three Aboriginal-owned tours operated by the traditional custodians of the local area.</p>
<b>Cape York Land Council</b>  <a href="http://www.cylc.org.au/">http://www.cylc.org.au/</a>	<p>Cape York Land Council exists to advance the self-determination of Aboriginal people of the Cape York Peninsula, ensure the continuation of traditional culture, provide for general social welfare, and ascertain the wishes, aspirations and opinions of its members relating to the management, use and control of traditional Aboriginal land in Cape York.</p>
<b>Cape York Aboriginal Australian Academy</b>  <a href="http://www.capeyorkpartnerships.com/education/academy">http://www.capeyorkpartnerships.com/education/academy</a>	<p>The Cape York Aboriginal Australian Academy (CYAAA) is a not-for-profit organisation led by Noel Pearson and Cape York Partnerships (CYP), which delivers a 'best of both worlds' education to Indigenous students. It aims to close the academic achievement gap between indigenous and mainstream students and to support Cape York children's bicultural identity.</p>
<b>Cape York Institute for Policy and Leadership</b>  <a href="http://cyi.org.au/">http://cyi.org.au/</a>	<p>The Cape York Institute was established in July 2004 as an independent policy and leadership organisation. The Institute champions reform in Indigenous economic and social policies and supports the development of current and future Cape York leaders. The Institute's Director is Noel Pearson, an Aboriginal leader and activist from the community of Hopevale.</p>
<b>Cape York Partnerships</b>	<p>Cape York Partnerships is a development organisation aimed at ensuring the people of Cape York Peninsula have the capabilities to choose lives they have reason to value.</p> <p>The organisation enables reform by building innovative partnerships between Indigenous individuals, families and communities, government</p>

<a href="http://www.capeyorkpartnerships.com/">http://www.capeyorkpartnerships.com/</a>	and the philanthropic and corporate sectors.
<b>Jawun</b>  <a href="http://jawun.org.au/">http://jawun.org.au/</a>	Jawun forms partnerships to benefit both corporate and Indigenous Australia. Together they improve the lives of Indigenous people around Australia by supporting Indigenous communities on the ground.