Executive summary

In its 2010 report *Contribution of the Not-for-Profit Sector*, the Productivity Commission (PC) observed that there is a need to develop a sustainable primary market for not-for-profit (NFP) debt in Australia. It considered that a lack of access to capital for NFP organisations could be due to concerns that NFPs are unable to service debt, the high costs for specialist financial intermediaries to provide capital, and the 'still young market' for capital that accepts returns in social as well as financial benefits. The PC argued the need for change in all three areas but noted that the Australian Government has limited experience in this area. Accordingly, the PC recommended that the federal government should establish an advisory panel 'to consider options and assess progress in developing a sustainable market for not-for-profit organisation debt products'.[1]

Whereas the PC considered these issues only in passing, this inquiry has focussed on the barriers and the options available to develop a mature capital market for the social economy sector in Australia. The committee has found that some of these constraints reflect on social economy organisations themselves: they lack a steady revenue stream to attract investment and the collateral to guarantee loans; they remain grant focussed and risk averse to debt and equity capital; and often lack the capacity and the organisational structure to raise equity capital. Other constraints to social economy organisations accessing debt and equity capital reflect the limitations of mainstream financial institutions. Many are unaware of the needs of social economy organisations, while others are dissuaded by the large transactions costs relative to the capital required by these organisations. In addition, the market has been stymied to some degree by the lack of an enabling regulatory environment and, in particular, the lack of targeted incentives for financial intermediaries.

A Social Finance Taskforce

In the committee's view, there is a clear need for strategic direction to coordinate the opportunities for social economy organisations to access capital in Australia. Currently, these needs are not coordinated and, as a result, many of the potential benefits for both social economy organisations and investors are not realised.

The central recommendation of this report is that a Social Finance Taskforce should be established. The Taskforce must have a high-level advisory role, similar to that which has operated successfully in the United Kingdom and Canada. It should identify and publicise opportunities for social economy organisations and the investment community to collaborate and shape a policy framework to develop a capital market

1 Productivity Commission, *Contribution of the Not-for-Profit Sector*, January 2010, p. 195.

for the social economy sector. The Taskforce should be composed of high profile and influential members from the mainstream finance sector, Community Development Finance Institutions (CDFIs), the superannuation industry, the philanthropic sector, the social sector itself and academia. The Taskforce should also have representatives from the departments of Treasury, Prime Minister and Cabinet and Finance and Deregulation.

The committee emphasises that the Taskforce must be separate from current arrangements to establish the Australian Charities and Not-for-Profits Commission (ACNC) and the work of the Office for the Not-for-Profit Sector and the NFP Sector Reform Council. Only as a separate body will social finance issues receive the prominence and the attention that they have lacked in the past.

Further, the committee is encouraged that key stakeholders support the idea of a Taskforce. Most notably, during the course of this inquiry, the Community Council for Australia (CCA) convened a roundtable of 15 social finance experts which commended a Taskforce. The CCA envisaged that the Taskforce should build on the work of this inquiry and provide recommendations to government on the capacity of the sector, its access to capital, enhancing the role of intermediaries and simplifying the sector's legislation and regulations.

Intermediaries and capacity building

As noted, social economy organisations are accustomed to a culture that is reliant on grant capital and are often risk averse to debt and equity capital. They often prioritise resources directly towards their social mission rather than developing the financial literacy and organisational capacity necessary for long term sustainability. Finding the means to explore emerging financial products for many social economy organisations is simply not an option. Additionally, organisations that do seek finance are often unable to present a robust business case and fail to engage potential investors. Without adequate capacity among social economy organisations, new forms of finance for these organisations may go unnoticed, and new types of capital may be mismanaged.

The delicate balance between supply and demand is best met through the work of specialist intermediaries which work to connect financial investors and mainstream financial institutions with social economy organisations. Financial intermediaries such as CDFIs actively engage with social economy organisations to build financial capacity, providing knowledge about the finance options best suited to the organisation and helping to link them to suitable sources of capital.

Intermediaries are integral to the infrastructure of a capital market for social economy organisations, although there are few currently operating in Australia. The committee has made several recommendations to support the current activities undertaken by intermediaries. The government's current CDFI pilot provides impetus to guide the development of the intermediary market, and the possibility of using tax incentives to encourage investment in CDFIs is also an option.

Education of financial and corporate stakeholders

The financial and corporate sectors have a crucial role to play in the development of a capital market for social economy organisations. Mainstream financial institutions are cautious of lending to social economy organisations, often not understanding the needs and realities of how these organisations operate. Additionally, there is a lack of awareness in the financial sector of emerging social investment products that could be a useful way of channelling capital into the sector. Financial advisors and planners have little expertise in social finance, and generally do not offer social investment opportunities as part of the range of options available to investors. Trustees of superannuation funds, philanthropic trusts and foundations are often unaware of the potential to make investments in social projects, and there is uncertainty around the extent to which they can invest in any ventures which may deliver a 'sub-commercial' rate of return.

The corporate sector is also a significant source of capital for the social economy, through corporate philanthropy and community investment initiatives. While there is a trend towards integrating corporate social responsibility and community investment into the core of business activities for many companies, there is still a need for company directors and senior managers to become more aware of social investment opportunities. The committee recommends that investors, financial advisors and corporate directors undertake educational and training opportunities relating to the social economy and emerging social investment opportunities. This will facilitate the engagement of the financial and corporate sectors more fully with social economy organisations.

Promoting social investment products

One of the primary ways to attract additional capital to the social economy is through new and innovative financial products. Financial intermediaries such as CDFIs are increasingly offering social economy organisations tailored financial products that fit their organisational needs, including new debt instruments, equity-type investments and long term 'patient finance'. The development of these products reflects the diversity among social economy organisations and allows them to access capital on a more consistent and equitable basis.

In addition to new products being offered directly to social economy organisations, there is a trend towards the development of new financial instruments which will help attract capital from mainstream investors into social ventures. The advent of social investment funds, which aggregate capital from a variety of institutional and retail sources and then provide finance to a range of social economy organisations, can act as a conduit between large-scale investors and small social organisations. Finance mechanisms such as social bonds provide an alternate means for raising capital for social projects, particularly infrastructure projects such as social housing developments. Additionally, the utilisation of social impact bonds and other pay-for-success financing models can allow government to pay for service delivery only when specified social outcomes are achieved.

These emerging social investment products have the potential to engage institutional investors, such as superannuation funds, that have not traditionally been involved in providing capital to the sector. These products may also increase the effectiveness and quality of the capital provided from existing sources such as philanthropy and the corporate sector. Support is required from government, the financial sector, and the social economy itself if the potential of these emerging options is to be realised and social investment is to become a mainstream feature of the Australian economy.

Strengthening social enterprise

The social enterprise sector has the capability to foster a great number of innovative approaches to target social issues. Social enterprises in Australia are currently servicing a broad range of societal needs and contributing to a diversified economy. Social enterprises generate a profit as part of their work, and reinvest the majority of that profit back into the fulfilment of their social missions. This in and of itself is generating finance for these enterprises. However, without access to suitable seed capital, the growth of the social enterprise sector is somewhat limited.

Further, providing finance to social enterprises differs to that of a commercial entity. The financial needs, as well as the social purpose, of a social enterprise must be taken into account to ensure its long-term viability. For example, a social enterprise should meet its own core operational costs to guarantee sustainability and guard against a reliance on fluctuating grant income. On the whole, mainstream financial institutions demonstrate a limited understanding of the capital needs of social enterprises and accordingly, do not offer them suitable financial products at start-up and beyond. Financial intermediaries are best placed to address this void, and the government's recent development of the Social Enterprise Development Investment Fund effectively supports two CDFIs to foster innovation in the social enterprise sector.

In addition to the assistance offered by intermediaries, there are a number of existing government programs supporting small businesses that could be extended to social enterprises. Measures should be taken to ensure that the extension of these programs considers the unique needs of social enterprises, and upholds their social purpose.

Government social procurement policies also play a key role in the development of the social enterprise sector and can provide social enterprises with opportunities to secure a long-term, stable source of revenue. The committee recommends options to improve the government's competitive tendering and contracting (CTC) framework and increase tendering opportunities for social enterprises.

Developing a measurement framework

Evaluation and measurement are fundamental to the development of a robust capital market for social economy organisations. Accepted performance metrics for the sector will instil confidence in potential investors, and offer an assessment of the risks and returns of different types of investments. Government, as a key investor in the sector, would also benefit from the development of a measurement framework as it would provide further insight into the operation of the sector as a whole and better inform funding decisions.

In addition, the emergence of social investment in Australia is dependent on the measurement of social returns. Social impact bonds in particular, can only be applied to policy areas that have measureable results. The committee recommends that policy areas that already utilise results based funding could inform the development of a measurement framework.

The committee recognises that the PC has undertaken significant work to develop a measurement framework for the sector which takes into account the diversity of the sector's activities and structures. While proposing a measurement framework for the social economy sector presents a number of challenges, the committee believes a framework applied consistently across governments will minimise compliance costs and maximise the value of data collected.

The measurement framework should be flexible and allow for a number of measurement methodologies. It should consider the sensitivities surrounding beneficiaries and the core social objective of organisations. To accelerate the take-up of this framework, and to reduce compliance costs for social organisations, the Office for the Not-for-Profit Sector should publish guidance material on the measurement framework that should be supplied to all Australian governments.

Recommendations

Establishing a Social Finance Taskforce

Recommendation 2.1

2.56 The committee recommends that the government establish a Social Finance Taskforce to assess mechanisms and options in the progress and development of a robust capital market for social economy organisations in Australia. The taskforce should initially report to government by July 2012.

Recommendation 4.3

4.71 The committee recommends that the proposed Social Finance Taskforce consider the potential for philanthropic trusts and foundations to invest a percentage of their corpus in social investments options, particularly with regard to:

- whether a requirement for philanthropic foundations to invest a percentage of their corpus in mission or program related investments is appropriate in the Australian context;
- how to develop appropriate social investment vehicles for philanthropic intermediaries; and
- any other mechanisms by which the corpus of philanthropic funds could be better utilised to invest in the social economy.

Recommendation 4.4

4.96 The committee recommends that the proposed Social Finance Taskforce consider the potential for superannuation funds and other institutional investors to invest in emerging social impact investment products, with particular regard to ascertaining:

- what clarification, if any, is necessary regarding the fiduciary duties of superannuation funds and their ability to engage with social impact investment opportunities;
- how social impact investment classes can be used as a portfolio diversification tool by superannuation funds;
- whether incentives may be required in order to attract institutional investment to the sector;
- how social investment funds can be developed to attract institutional investment; and
- what possible mechanisms are available to lower the transaction costs for institutional investors seeking to engage with social investment opportunities.

Recommendation 5.2

5.98 The committee recommends that the proposed Social Finance Task Force consider possible options to develop Community Development Financial Institutions in Australia, taking into account:

- the findings of the forthcoming study commissioned by the Department of Families, Housing, Community Services and Indigenous Affairs into the current regulatory and legislative environment for Community Development Financial Institutions in Australia;
- whether tax incentives should be established to encourage investment in CDFIs in Australia; and
- any other initiatives that may benefit the development of CDFIs investing in social economy organisations.

Education, awareness and capacity building

Recommendation 4.5

4.104 The committee recommends that professional organisations such as the Australian Institute of Company Directors and investment advisory services develop materials and professional development workshops to inform the corporate sector of investment opportunities in the social economy.

Recommendation 5.1

5.28 The committee recommends that philanthropic and financial advisory services promote and encourage opportunities for social investment and engagement with the sector.

Recommendation 6.1

6.32 The committee recommends that programs and workshops relating to social impact investment be developed by investment organisations to encourage investors to engage in social investment projects and opportunities.

Promoting social investment products

Recommendation 4.1

4.69 The committee recommends that the Australian Taxation Office, in consultation with the Australian Charities and Not-for-Profits Commission and other relevant stakeholders, issue explanatory material for Private Ancillary Fund trustees informing them of:

- the ability of these funds to treat any discount to the market returns on social investments as benefit for the purpose of the minimum distribution requirements; and
- the necessity of including a clause regarding social investment classes in their investment strategy documents in order to invest in social investment products.

Recommendation 4.2

4.70 The committee recommends that the Commissioner of Taxation, Treasury and the Office for the Not-For-Profit Sector work to create benchmarks and standards for financial returns on social investment classes such as debt products and social bonds, in order to help trustees and fund managers make informed investment decisions in this area.

Recommendation 6.2

6.96 The committee recommends that the Departments of Treasury and Finance and Deregulation to examine ways to create incentives to invest in a social bond market in Australia including the feasibility of tax exempt income returns, a government top up on coupons through cash or tax credits and the use of government guarantees.

Recommendation 6.3

6.97 The committee recommends that the Office for the Not-for-Profit Sector identify policy areas where social impact bonds could be applied, including intractable problems in indigenous communities. The plausibility of creating social impact bonds in partnership with state governments should also be examined.

6.98 The Office for the Not-for-Profit Sector should work with relevant government departments and agencies and social organisations to implement a social impact bond trial.

Strengthening Social Enterprise

Recommendation 8.1

8.75 The Office for the Not-for-Profit Sector identify relevant current and future government programs, such as Enterprise Connect and the New Enterprise Incentive Scheme, that could be extended to offer specialised support for social enterprises. The programs should be extended to include support for cooperatives, employee share ownership plans and employee buyouts.

Recommendation 8.2

8.76 The Department of Finance and Deregulation, Treasury and the Office for the Not-for-Profit Sector should jointly conduct a review of the competitive tendering and contracting framework and examine the costs and benefits of:

- social tendering to identify a social purpose business rather than a competitive tendering process; and
- including a community/social benefit criterion in the call for and assessment of competitive tenders.

Developing a measurement framework

Recommendation 7.1

7.38 The committee recommends that the Department of the Prime Minister and Cabinet identify policy areas where results based funding is already utilised and use any relevant programs as an evidence base towards the development of a robust measurement framework for social economy organisations in Australia.

Recommendation 7.2

7.39 The committee recommends the Office for the Not-for-Profit Sector in the Department of the Prime Minister and Cabinet prepare a guide for social economy organisations to assist in evaluation of their performance. The guide should be based on the evaluation framework recommended by the Productivity Commission using inputs, outputs, outcomes and impacts and include Australian case studies and emerging international measurement tools.

7.40 The guide should provide social economy organisations with a number of measurement techniques as options to measure their outcomes and impacts. The committee recommends that the guide be adopted by the Council of Australian Governments and distributed to all government departments and agencies.