Is it Possible to do Well and Do Good?

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There are multiple perspectives of social investment and legal issues as well as risk need to be addressed by charity trustees in a changing environment. However, as the article points out the social investment market can be a significant source of funding

Whether marketed as 'social', 'impact' or 'mixed motive' investment, it is undeniable that the hype surrounding investments that combine social and financial returns is at fever pitch, with one US economist commenting that the world of philanthropy was experiencing a 'Big Bang moment'.

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Lauded as the future of philanthropy, it is hoped amongst its advocates that social investment will become a solid alternative to no-strings-attached giving.

However, despite the government's agenda firmly encouraging social investment and the social investment market growing apace, the general reaction within the philanthropy sector is one of bemused enthusiasm, revealing a real lack of understanding both among potential investors and investees as to what social investment is and how it is relevant to them.

So, first things first, what is social investment? Big Society Capital, an independent financial body established by the UK government to develop social investments in the UK, defines social investment as 'the provision and use of capital to generate social as well as financial returns.' Where traditional philanthropy relies chiefly on grants provided by individuals, foundations and corporate philanthropy programmes, social investment engages commercial banks, pension funds, insurance companies and specialized investment funds to provide large capital injections, primarily in the form of secured lending.

It is hoped that, by tying social and financial benefit, social investment will introduce a new range of entrepreneurial philanthropists to the sector. As the investor has a vested interest in seeing the project flourish, it is anticipated that this new way of giving will catalyse a more active and long-term engagement between investor and investee.

As the market develops, a bewildering array of products are increasingly becoming available, each designed to appeal to varying investor attitudes. For those interested in riskier and more innovative investments, products are available that directly link the impact generated with the returns offered to investors. For example, in 2010, Social Finance launched the first Social Impact Bond (SIB), with investors financing a range of interventions designed to prevent re-offending among a group of short-sentence prisoners.

The intention of the SIB is that if the service achieves the desired outcome then the investors receive an outcome payment, funded by the Big Lottery Fund and the Ministry of Justice. However, despite its label, unlike a traditional bond, all of the investor's capital is at risk of being lost if the service underperforms. The first outcome payment is due during Summer 2014. However, the Ministry of Justice published preliminary figures from the project's first year which showed a 20 per cent reduction in the frequency of re-convictions compared to the national average, indicating that the interventions were having some effect on the rates of recidivism in the area.

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For those looking for a less risky investment, Threadneedle Investments and Big Issue Invest are in the process of launching a product advertised as a 'mainstream' way of accessing the social investment market. Based on an established asset class – bonds – Threadneedle claim that their investment strategy has the ability to deliver respectable financial returns and daily liquidity, as well as positive social outcomes. Demand for this product launch, marketed to a broad investor base ranging from pension funds through to ISA investors, appears to mark the beginning of the transformation of the social investment industry from a niche sector to part of the mainstream economy.

The growing attention of policy-makers further indicates the increasingly mainstream nature of the social investment market. The government has continued to press ahead with the proposals announced last year to provide tax incentives for investment in qualifying social enterprises. In certain circumstances capital gains will be able to be deferred with qualifying investments; capital gains arising on disposals of these investments will be tax free; and income tax relief will be available at 30 per cent of the amount invested.

Although the tax relief may provide a further incentive for investors to get involved, it must be made clear that entering the social investment market is a decision not to take lightly, especially for potential charity investors. It is estimated that charitable organisations have committed £100 million to social investment to date, taking advantage of the benefits of 'recycling' their funds rather than committing them outright.

However, in a report published in April 2014, the Law Commission concluded that charity trustees must be incredibly careful that, by engaging in social investment, they are not acting outside their powers. The Law Commission reported that a charity trustee's power to invest may only be used to make a social investment if the investment is anticipated to provide a 'positive financial return', by which they mean a return beyond mere repayment of the initial capital outlay. Due to the high risk nature of some social investments, it would, in these circumstances, be impossible for trustees to expect a positive financial return.

The lack of clarity in the law, when combined with the risks of entering an industry that lacks a solid track record, makes it clear that any charity trustee must carefully consider any step to enter the social investment market, with legal advice strongly recommended.

The social investment market is clearly a dynamic and potentially lucrative source of funding, with social investments seemingly sitting happily alongside traditional charitable grants and wider investment portfolios. However, the social investment market is still relatively embryonic, with the risks applying to specific social investment opportunities uncertain and perhaps somewhat difficult to predict. It is still too early to predict whether the hype is well-deserved. Still, it cannot be denied that the market is promising, offering hope to charities increasingly struggling for funding. Social investment demonstrates that it is possible, when investing, to do well and to do good at the same time, with outright giving no longer the only way to create social benefit.