



**SOCIAL | TRADERS**

**SOCIAL IMPACT  
INVESTING  
DISCUSSION  
PAPER**

Social Traders' Submission

24<sup>th</sup> February 2017

## About Social Traders

Social Traders Ltd is an independent, not-for-profit organisation established to facilitate, support and advocate for the development of social enterprise in Australia. Social Traders is the only Australian organisation specialised in supporting the social enterprise sector.

As the leading social enterprise development organisation in Australia, Social Traders' vision and strategy for social enterprise are designed to build on the progress achieved over the last seven years and capitalise on this momentum to help launch social enterprise into the mainstream by 2025.

Social Traders' vision is that by 2025 social enterprise will contribute significantly to the Australian economy comprising 4% to 5% of GDP and employing over 500,000 Australians. Australian social enterprise will identify as a new industry sector, speak with a coordinated voice and be recognised for its collective contribution to creating a fairer society and economy. The number of social enterprises will increase from 20,000 to 30,000, and the economic growth generated by social enterprise will provide a sustained increase in the workforce participation rate.

To achieve this vision, Social Traders works to accelerate the importance of social enterprise and social procurement in Australia, demonstrating the potential of social enterprise to create jobs for marginalized groups, increase access to services and strengthen local communities and economies. Our key objectives are to:

1. Grow the visibility, voice and value of social enterprise
2. Build a pipeline of innovative and viable social enterprises
3. Open new government and corporate markets to social enterprises

## Social enterprise in Australia

To tackle Australia's economic and social challenges, new approaches to doing business and social change are required. Social enterprise offers a new approach. Social enterprise can be found in every industry of the Australian economy, in small communities and large institutions and their efforts are helping to solve a wide variety of social problems.

Already, there are 20,000 social enterprises operating in Australia<sup>1</sup>. The number of enterprises is estimated to have grown at a rate of 37% over the past five years. In 2006, commercial (social enterprise) activity represented over 39% of revenue in the not-for-profit sector<sup>2</sup>. While progress has been made at the micro-level to support social enterprise development by a range of intermediary organisations, corporates and philanthropic foundations, with the exception of Victoria, which now has a Social Enterprise Strategy, there has been only fragmented and ad-hoc progress at the macro policy level.

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<sup>1</sup> Finding Australia's Social Enterprise Sector: Final Report 2010. Australian Centre for Philanthropy and Nonprofit Studies, QUT & Social Traders. [http://www.socialtraders.com.au/uploads/rsfil/000263\\_bcds.pdf](http://www.socialtraders.com.au/uploads/rsfil/000263_bcds.pdf)

<sup>2</sup> Productivity Commission, 2010, *Contribution of the Not-for-Profit Sector*, Research Report, Canberra. <http://www.pc.gov.au/inquiries/completed/not-for-profit/report>

## The relationship between social enterprise and social impact investment

Social Traders welcomes the Government's publication of its Discussion Paper on Social Impact Investment. However, we encourage the Government to not consider the development of an impact investment market in Australia as an ends in itself. Social Traders believes that Social Impact Investment is an enabler for the sustainable delivery of innovative solutions to some of our most significant social problems, and one of those solutions is social enterprise. As such, social impact investment is a tool and an important part of the social enterprise ecosystem.

The latest Australian social enterprise census<sup>3</sup> has highlighted gaps in the social enterprise ecosystem related to skills, governance, markets, capital and awareness. Bridging these gaps has the potential to significantly increase the scale and contribution of social enterprise to create a more inclusive society where business is used for good and wealth is shared more fairly. Therefore, Social Traders welcomes the Australian Government recognising the role it can play in enabling the growth of the Australian Social Enterprise Sector through developing the Australian impact investment market.

To accelerate their growth, social enterprises in Australia need to have access to market opportunities, support services and appropriate capital so they can grow to their full capacity and achieve scale appropriate to their businesses and missions. Social impact investment sits within a broad continuum of capital that may be appropriate for social enterprises to fund their establishment and growth, depending on:

- The stage of development of the enterprise and the associated risk profile
- The social purpose of the enterprise and its business model – some sustainable and highly successful (impactful) social enterprises are financially marginal
- The quantum required
- The risk appetite of directors
- The legal form of the enterprise
- The cost of capital
- The terms of capital provision – security, terms of repayment, etc.

### ◆ Comment 1: Defining social enterprise

The Discussion Paper defines social enterprise as “businesses which aim to achieve both financial and social outcomes through their work.” (p 10; p21). This definition, whilst broadly consistent does not fully align with the commonly held definition applied to social enterprise in Australia<sup>4</sup> and internationally<sup>5</sup>, which has three major elements:

- i. Social enterprises are organisations that have a primary purpose of providing a social/environmental public benefit – that is, the community/public benefit is superior to any ancillary private benefit; and
- ii. The social benefit purpose is achieved through a revenue generated trading model – that is, revenue generated through trade is in excess of other income sources such as donation/grant capital; and
- iii. Irrespective of company legal structure, the majority of profits/surpluses are used to address the social purpose, reflective of the community/public benefit is superior to any ancillary private benefit.

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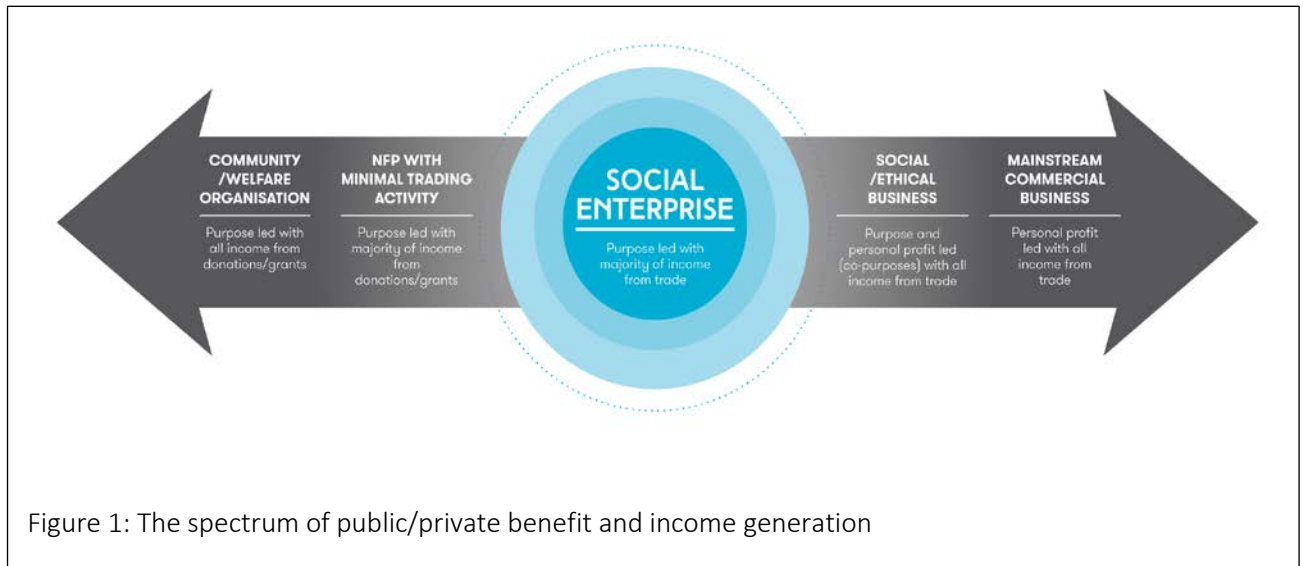
<sup>3</sup> Finding Australia's Social Enterprise Sector 2016: Final Report. CSI Swinburne & Social Traders.

<http://cdn.socialtraders.com.au/app/uploads/2016/07/FASES-2016-full-report-final.pdf>

<sup>4</sup> Finding Australia's Social Enterprise Sector: Final Report 2010 *op cit*

<sup>5</sup> For example: Social Enterprise UK <http://www.socialenterprise.org.uk/about/about-social-enterprise>

Social enterprise is one form of many impact-generating business models that exist on a spectrum of public/private benefit generated and the main source of income (donation/grant versus trading), as shown in Figure 1. Within this spectrum, so long as measureable social impact is being generated any of the forms below could receive social impact investment capital.



## ◆ Comment 2: Social enterprise is a business model not an impact investment

The Discussion Paper suggests three main forms of social impact investing (section 2.2, p10):

1. Social Impact Bonds
2. Social Enterprise
3. Social Impact Investment Funds

Social Traders does not agree with the conceptualisation of 'social enterprise' as a form of social impact investing. This framework of social impact investing, as presented by the Discussion Paper does not differentiate between *forms* of investing and possible *recipients* of impact investment capital. Both Impact Bonds and Impact Investment Funds are mechanisms/structures for impact investment; social enterprise is one of many business models that may/may not receive impact investment capital as part of its financing strategy.

In Australia and internationally, significant amounts of social impact investment has gone into other impact-generating business models, including traditional charitable/welfare organisations that access impact investment capital to purchase property assets<sup>6</sup>. It is not informative to separate out social enterprise from other impact generating business models as a form of impact investment. Conversely, if forms of impact investment are to be conceptualised by the types of investees, it would be informative to add other potential recipients to this framework such as: social infrastructure provision, social/ethical business, etc.

## ◆ Comment 3: Challenges for social impact investing *and* social enterprise

The Discussion Paper notes that the current lack of social investment opportunities with a market rate of return is a challenge for the development of a social impact investment market in Australia. Consistent with Impact Investing Australia's (IIA) research in this area, Social Traders would suggest that this challenge exists because of the miss-match between the needs and expectations of investors and those of investees. IIA's research suggests that 58% of potential and active impact investors expect market rates of return, while 90% want that impact to be measured, with 40% of these expecting third party verification of measurement<sup>7</sup>.

At the same time, the 2016 Finding Australia's Social Enterprise Sector (FASES 2016) research study found that access appropriate forms of finance and impact measurement were amongst the five most significant challenges facing Australia's social enterprises<sup>8</sup>.

If we are to successfully develop a social economy in Australia, of which social enterprise and social impact investing are a part, we need to take a full ecosystem view. This means developing the social impact investment market in parallel with developing the capacity of impact generating organisations and projects (including social enterprises) to absorb that capital and generate a financial and social return.

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<sup>6</sup> Big Society Capital have performed analysis of the various revenue/business models accessing social impact investment in the UK, social enterprise is one of many <http://www.bigsocietycapital.com/sites/default/files/Evidence%20Pack%20-%20UK%20Social%20Investment%20-%20Opportunities%2C%20Challenges%2C%20and%20Critical%20Questions.pdf>

<sup>7</sup> Impact Investing Australia 2016, Investor Report <https://impactinvestingaustralia.com/wp-content/uploads/Impact-Investing-Australia-2016-Investor-Report.pdf>

<sup>8</sup> Finding Australia's Social Enterprise Sector 2016: Final Report *op cit*

#### ◆ Comment 4: Government's role

The Social Enterprise Development & Investment Funds (SEDIF) was the most significant intervention the Australian Government has made to date in developing an impact investment market in Australia. Social Traders believes that the recent SEDIF Evaluation report is an informative reflection that provides an excellent framework for how Government can both advance development of the social impact investment market and promote social enterprise development<sup>9</sup>. The SEDIF Evaluation Report cites 11 recommendations related to social enterprise development, advancing impact investing and evaluating future Government initiatives. Social Traders supports these recommendations and calls for their consideration as part of this Discussion Paper.

Specifically, in line with the SEDIF Evaluation recommendations, Social Traders believes:

##### *Government has a role in capacity building*

Currently, social impact investment is not meeting the needs of most Australian social enterprises; there is no shortage of enterprises but there is a shortage of 'deals' because of a disconnect between the needs of many impact investors – market return, measured and validated impact – and the needs and abilities of investees to meet these, impeded by the additional 'burden' of impact generation and measurement.

In the context of an unbalanced and nascent social impact investment market, Government has a significant role to play in contributing to early market infrastructure and capacity building. This includes supporting and facilitating a suite of products and support services for social impact investment recipients, as has been the case in other countries where social impact investment is more advanced, such as the UK.

Both the recent review of the SEDIFs<sup>10</sup> and Social Traders' own work<sup>11</sup> demonstrate this disconnect between current market supply and demand. The SEDIF evaluation recommends that Government's future investments in social enterprise development should include business capability development that extends beyond the provision of impact investment capital. It also recommends that future initiatives targeted at increasing social enterprises' access to finance include a breadth of social finance options – particularly grant finance, patient capital, and early-stage risk capital. By supporting the entire capital supply continuum, Government will build a robust supply of social impact investment opportunities.

##### *Government has a role as customer – social procurement*

The Discussion Paper does not acknowledge the role that Government can play in creating an enabling environment through social procurement. The SEDIF Evaluation Report recommends that market stimulation and specifically extending current indigenous procurement requirements viz. the Indigenous Procurement Policy (IPP) to include social procurement, is an important element of ecosystem development.

At a state level the NSW Office of Social Impact Investment (OSII), a joint initiative of the NSW Treasury and the NSW Department of Premier and Cabinet (DPC), was established to facilitate growth in the social impact investment market. The OSII oversees and leads the implementation of the NSW Social Impact Investment

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<sup>9</sup> SEDIF Evaluation Report 2016 *op cit*

<sup>10</sup> SEDIF Evaluation Report 2016 <https://docs.employment.gov.au/system/files/doc/other/sedifevaluation.pdf>

<sup>11</sup> Mind The Gap: Why social enterprise needs more than impact investment, 2015 Social Traders <http://www.socialtraders.com.au/news-and-events/mind-the-gap-why-social-enterprise-in-australia-needs-more-than-impact-investment/>

Policy<sup>12</sup>, which includes social procurement in its remit. This approach acknowledges the relationship between government's procurement activities and the opportunity created for social impact investment to finance the delivery of the procured product or service.

The Victorian Government has recently made a commitment to developing a Social Procurement Framework across Government, as part of its recently announced Social Enterprise Strategy.

### *Government has a role as a policy leader – social enterprise strategy*

The Discussion Paper suggests that Government could play a stewardship role by ensuring an appropriate regulatory environment for the growth of the social impact investment market. In line with the recommendations of the McClure Report<sup>13</sup>, Social Traders believes that realising growth in the social impact investment market requires Government must steward growth in the entire ecosystem – supply, demand and intermediaries. This could be best achieved by the Government developing a Social Enterprise Strategy for Australia, to facilitate the role that social enterprise could have in growing the social impact investment market.

#### ◆ Comment 5: Legal Structures for Social Enterprises

Social Traders suggests that the section 5.4 of the Discussion Paper acknowledge that only *for profit* social enterprises can *issue* equity capital (first sentence). Conversely, charitable not-for-profit social enterprises have the advantage of being able to access tax-deductable donation grant capital.

The majority of social enterprises in Australia exist within not-for-profit legal structures; under 20% have a Pty Ltd structure<sup>14</sup>.

The 2016 FASES Research undertaken by the Centre for Social Impact, Swinburne and Social Traders sought feedback from social enterprise operators on the question of whether a new legal form would help organisations achieve their goals. There was a lack of consensus on this matter, with the majority of respondents (46%) considering this of neutral importance.

Social Traders does not agree with the proposition made in the Discussion Paper (p32) that social enterprises' difficulty accessing capital is *directly* linked to their legal structure. The barriers to appropriate capital are more complex than a pure case of an inability to access equity, as has been demonstrated in the UK through the relatively low issue of equity capital through the CIC structure. Barriers to capital include elements on both the supply and demand side, as discussed earlier in this document, as well as broader market forces that do not behave in the same way as traditional commercial markets<sup>15</sup>.

We have had no experience of directors facing a breach of duties as a result of making decisions that reflect the purpose of the company. This risk seems unlikely as the fiduciary duty of directors is to achieve company purpose and avoid insolvent trading, not necessarily to maximise profits. Given the majority of for-profit social enterprises are small, proprietary limited (Pty Ltd) structures, shareholders tend to be directors aligned with the enterprise's purpose.

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<sup>12</sup> NSW Social Impact Investment Policy <http://www.osii.nsw.gov.au/assets/office-of-social-impact-investment/files/Social-Impact-Investment-Policy.pdf>

<sup>13</sup> A New System for Better Employment and Social Outcomes, Final Report. Department of Social Service [https://www.dss.gov.au/sites/default/files/documents/02\\_2015/dss001\\_14\\_final\\_report\\_access\\_2.pdf](https://www.dss.gov.au/sites/default/files/documents/02_2015/dss001_14_final_report_access_2.pdf)

<sup>14</sup> Finding Australia's Social Enterprise Sector 2016: Final Report *op cit*

<sup>15</sup> Mind The Gap: Why social enterprise needs more than impact investment, 2015 Social Traders *op cit*

## ◆ Comment 6: Program Related Investment

Access to capital appropriate to the development needs of social enterprises is a significant barrier to sector growth in Australia<sup>16</sup>. Therefore Social Traders is supportive of amendments to the Private Ancillary Fund Guidelines 2009 and the Public Ancillary Fund Guidelines 2011 to allow for an enhanced program related investments (PRI) framework that would enable social enterprises access to more flexible capital with a higher risk threshold.

Social Traders is supportive of the work undertaken by Philanthropy Australia in this area, particularly their calls for an enhanced Program Related Investments Framework, which would include allowing ancillary funds to make loans to DGRs that would count the full amount of the loans as part of their minimum annual distribution, with any repaid principal added to the minimum annual distribution in the year it is repaid.

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<sup>16</sup> Finding Australia's Social Enterprise Sector 2016: Final Report *op cit*