The Growth Fund

1 INTRODUCTION

The Growth Fund was established as a response to the lack of more risk bearing investments of less than £150,000 for charities and social enterprises. The Growth Fund will combine a £22.5m Big Lottery Fund grant, matched with at least £22.5m in loan funding from BSC to provide grant and loan funding to enable Social Investment Finance Intermediaries (SIFIs) to plug this gap.

Although charities and social enterprises have been blending funding for many decades, a wholesale initiative of this type is a new development for the social sector. Over time it is hoped the models piloted through the Growth Fund will help inform the wider Social Investment market and shed light on how risks could be more appropriately considered to maximise social impact and the range of organisations for whom social investment could be a tool to create further social change.

2 THE PROBLEM THE GROWTH FUND IS AIMING TO SOLVE

The social investment market has grown significantly over the last 5 years enabling a greater number of charities and social enterprises to access the finance needed to create an impact on society. There are now over 20 SIFIs offering a range of investment products across the UK and for organisations delivering social impact for different beneficiary groups. There is also a range of support available for charities and social enterprises that are looking to take on investment.

However there remain a number of barriers that prevent smaller, earlier stage and innovating VCSEs from accessing investment. From the VCSE perspective, in spite of the increase in social investment funds, relatively smaller amounts of high risk finance appear to be elusive; recent research[1] reveals this to be the most demanded but least available type of finance by small and medium sized VCSEs. Whilst VCSEs are often adept at mixing available financing options, this approach is time consuming, resource dependent and uncertain for longer term planning.

From a grant funder's perspective, the lack of early stage equity-like risk capital, has meant that a variety of foundations, public bodies and government are using limited grants strategically as risk capital to enable VCSEs to test out innovative concepts, to pilot new ways of working, and to provide capacity to an organisation with ambitious social goals. The Growth Fund develops this concept further by combining grants with loan finance to offer unsecured investment of less than £150,000 to organisations in the form and at the time when they most need it.

At the outset of the Growth Fund, it is not clear to the funders whether this financing gap is a permanent or temporary one in the social investment market. These two scenarios have different implications for the use of grants, which are limited in supply and need to be used to maximise sustainable social impact. The Growth Fund evaluation process will seek to address this question, using evidence gathered from investments made over the 7 year life of the programme. Findings will provide valuable insight for grant funders and investors on the best use of grant funding in the future.

[1] CAF Venturesome: In Demand (2014); ClearlySo and NPC: Investment Readiness in the UK, (2012)

Barrier to accessing finance	Underlying market failure	Solutions at SIFI level
SIZE – most investments offered by existing SIFIs are greater than £250K	**HIGH TRANSACTION COSTS** – Due diligence and origination takes a considerable amount of resource and is uneconomic for smaller deals	**A** Pool of money to cover operating costs (including origination, due diligence and ongoing support)
PRICE- the cost of finance is seen to be unaffordable by frontline organisations	**UNKNOWN RISK** – Insufficient information available to investors on the risk and social impact return of each transaction which can result in a higher price **SOCIAL IMPACT** the social value to society created through an organisation is only partially integrated into the pricing of an investment	**B** Pool of money to cover unknown risk (both actual and perceived) at SIFI level and build a track record over time on "actual risk"
RISK to ORGANISATION – trustees and executives of charities and social enterprises have concerns about taking on investment for the first time	**LACK OF INFORMATION** – insufficient support and information for organsiations at earlier stages of developing trading models	**C** Pool of money to derisk at frontline level by providing a grant alongside a loan **A** Pool of money to top up SIFI operating costs and enable them to widen outreach

The Growth Fund was set up to address these barriers by piloting and demonstrating the potential effectiveness of other models of channelling socially motivated capital to VCSE organisations. To pilot these models the Growth Fund would enable organisations to access loan capital as well as grant capital for the three purposes set out below:

A	Use of grant to encourage SIFIs to make smaller social investments , given that operating costs for smaller deals are higher
B	Capital to take on some of the risk in perceived riskier deals *to incentivise SIFIs to make investments into a wider range of charities and social enterprises*
C	Use of grant to pass on directly to frontline organisations as alternative financial product which *reduces the amount of loan finance required so that revenue streams are robust enough for repayment*

The Growth Fund is designed in a way that is able to use valuable grant funding most efficiently to support VCSE organisations and in doing so, create social impact.

Additionally there are a number of non-financial barriers that also contribute to a difficulty of accessing finance including terminology, understanding of the risk/reward tradeoffs, trustee engagement and others. It is likely the Growth Fund alone would not be able to address all of these barriers but BSC, Big Lottery Fund and Access will continue to engage in activities that address these issues.

3 WHAT SUCCESS LOOKS LIKE

The Growth Fund aims to increase the social impact of those VCSEs across England for whom taking on some degree of repayable finance is appropriate. It will do this by providing loan and grant funding to SIFIs, to provide more appropriate finance of up to £150,000 to VCSE organisations which are unlikely to have accessed social investment but need investment to support them in their activities. These investments to VCSE organisations may be in the form of a loan, grant and loan or some other form of blended investment.

By creating blended financial packages in appropriate forms to these organisations who are currently likely to be excluded from most forms of repayable finance, the Growth Fund expects:

At the level of charities and social enterprises

- VCSE organisations are able to develop their enterprising activity in order to deliver social impact on a more sustainable basis and/or increase their social impact. This might lead to growth or to stronger more resilient VCSEs which are better able to generate social impact from their activities over the longer term
- Demonstration of new approaches to investment by blending grants with loans in simple, smaller size products which meet the needs of charities and social enterprises
- Greater appetite by VCSEs to manage and mitigate the risks to social impact alongside the financial risks when taking on social investment.

At SIFI level

- The investment activities of SIFIs are extended to include those VCSEs who previously have not managed to access social investment, as a result of the incentives created through the package received from the Growth Fund
- New partnerships between those with lending expertise and organisations with the ability to reach new frontline organisations
- Likely increased efficiency through, for example, developing lean operating models
- Greater understanding of performance risks including costs, efficiency as well as financial risks undertaken by investing in this target group of front line organisations (which could be further categorised by geography or sector over time) and of the VCSEs' own risks
- Change in behaviours of SIFIs to become more responsive to the needs of charities and social enterprises
- Greater understanding of the trade offs within investments between social and financial returns, and clarity on how SIFIs will best assess collate and report on social impact.

Market level: (supported by evaluation throughout the lifetime of the Growth Fund)

- New models of social investment that appropriately support VCSEs
- Greater understanding of the likely SIFI operating costs needed to support the investment strategy, and the trajectory of these over time
- Better availability of information on the actual financial and social risk of social investment to enable market development
- Evidence base / longitudinal cohort of organisations from whom to track social and financial returns arising from a range of different product combinations

- Effective learning for funder organisations, service providers and others social investment market about the level of actual performance risks, impact risks and financial risks and the role of grant as complement to stimulating investments to finance the delivery of longer lasting change through increased social outcomes.

The market level outcomes will be linked to and will inform the current initiatives in this field.
At the same time it is important to note the Growth Fund is a limited intervention not designed to address wider barriers in the social investment market. The Growth Fund is unlikely to provide:

- Risk capital for start-ups with less than a year of trading history (other interventions in the market such as the Social Incubator Fund are able to support that end of the market)
- Cheaper secured lending for established organisations than currently offered by market lenders.
- Support for new SIFIs start-ups (the small operating cost subsidy will be sufficient solely to cover the costs associated with disbursing the Growth Fund and will be insufficient to enable a new SIFI to enter the market).

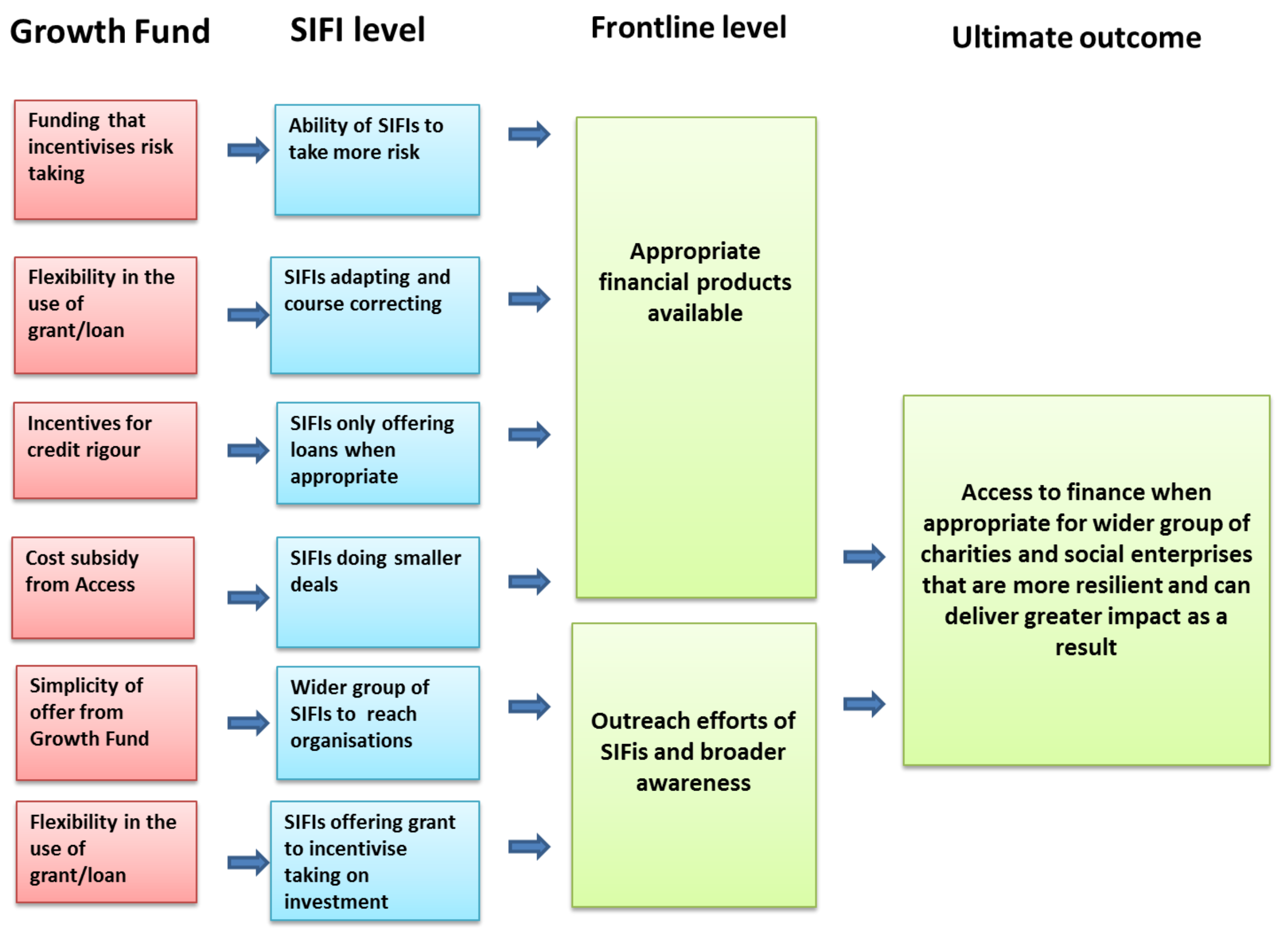
The Capacity Building programme[2] that Access will run alongside the Growth Fund, will help support the wider business needs of the frontline organisations, and of intermediaries where appropriate. This will help provide a comprehensive set of complementary interventions to this target group.

[2] This programme will be funded by the Cabinet Office and will run for at least 10 years from 2016

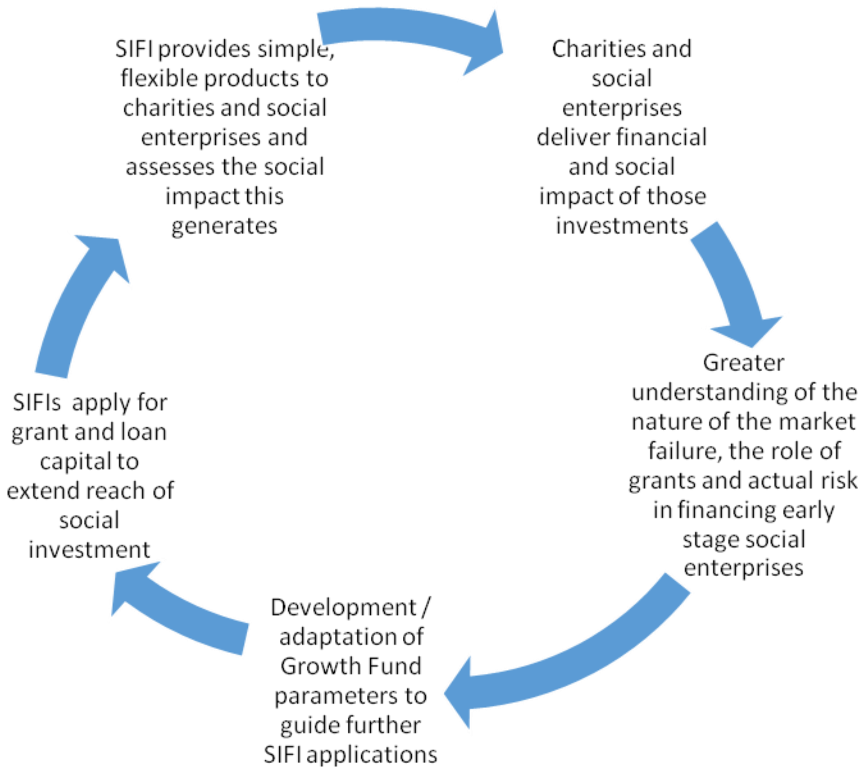
4 Theory of Change of the Growth Fund

To achieve those outcomes at the level of SIFIs and the level of charities and social enterprises it is the ambition of the parties involved in the Growth Fund to:

- Provide simplicity and clarity in the offer both to frontline organisations and to intermediaries
- Structure deals in a way that encourages responsiveness of SIFIs to VCSEs needs and which experiments with various product options to improve understanding
- Create incentives for both greater financial risk-taking to widen reach of social investment and the corresponding social impact generated , whilst rigorously ensuring that organisations are not burdened by debt when not appropriate
- Put in place a framework for evaluating and evidencing the social impact generated across the SIFI portfolios
- Provide appropriate cost support for SIFIs to do smaller deals
- Use the funding and soft tools available to create a new landscape of social investment.



It is intended that the there is a constant feedback loop that will shape the theory of change:


SIFI provides simple, flexible products to charities and social enterprises and assesses the social impact this generates
Charities and social enterprises deliver financial and social impact of those investments
Greater understanding of the nature of the market failure, the role of grants and actual risk in financing early stage social enterprises
Development / adaptation of Growth Fund parameters to guide further SIFI applications
SIFIs apply for grant and loan capital to extend reach of social investment

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