The Growth Fund – Due Diligence and Assessment

Guidance on how the Business Plan will be assessed, including the Due Diligence process

August 2016

Where is due diligence within the process?

STAGE 0: Social Investor expresses interest via EOI

STAGE 1: Social Investor provides business case to Access (after being invited to apply)

STAGE 2: Following JIC approval, due diligence of application by Access and BSC

STAGE 3: Signing of all legal agreements

ONGOING: Monitoring of activities

Invited to apply if eligible & suitable

1ST formal committee decision

2ND formal committee decision

Expression of Interest (EOI) form received

Initial consideration of eligibility of social investor by Access. If successful, invited to apply.

Business plan received

Review strategic fit with Growth Fund. Proposal to include: market gap; proposed solution; social impact; track record; risks; benefits to the market

JOINT INVESTMENT COMMITTEE (JIC) INITIAL ROUND

Assessment, Due Diligence

Validate info and dig deeper into Business Plan. Consider key issues raised by JIC, including any State Aid issues

JIC FINAL ROUND

Legals

Loan agreement signed between BSC & social investor; Agreement between Big Lottery Fund & social investor; Incorporate legal entity to manage funds

Ongoing Monitoring

Disbursing funds; Quarterly reporting; Course correction based on performance and experience; Portfolio reviews with JIC

Once a Business Plan has been approved by the JIC in the initial round, the proposal needs to be assessed for feasibility and subjected to detailed scrutiny. This is done via a Due Diligence process which will form the basis of the report back to JIC for the final round where they consider whether to approve the proposal and award funding.

This guidance will seek to answer:

- What is Due Diligence and why is it necessary?
- What are the areas that Due Diligence will cover?
- What can a social investor expect during the Due Diligence process? (i.e. what are the practicalities?)

What is due diligence and why is it necessary?

WHAT IS DUE DILIGENCE?

Some **definitions** of Due Diligence include:

*"an **investigation of a business prior to signing a contract**, or an act with a certain standard of care"*
*"an **investigation or audit of a potential investment** to **confirm all material facts**, such as reviewing all financial records plus anything else deemed material to the investment"*

Due Diligence is performed on the Growth Fund proposal/Business Plan to:

- Obtain a **deeper understanding** of the proposal and the social investor as an organisation
- **Test and understand the robustness of the assumptions** used and review the evidence in determining these assumptions
- Ensuring the social investor **can deliver what they say they can** in the Business Plan
- Potentially **develop the proposal further** in under developed areas/aspects

The Due Diligence process is **not designed to "catch out" the social investor**. By agreeing the proposal at the Initial Round, the JIC has already indicated that it is well disposed to the application. Rather it should be viewed as a **collaborative process** which includes the social investor having the opportunity to better understand the requirements of running a Growth Fund programme and what would be expected from them in return for the financing.

WHY IS DUE DILIGENCE NECESSARY?

The theory behind Due Diligence is that in performing this type of investigation, it **contributes significantly to informed decision making** by enhancing the amount and quality of information available.

The Growth Fund is part financed by The Big Lottery Fund (grant funding) and Big Society Capital (loan financing). Both organisations are **funded from public sources** and it is critical that any funds utilised are subject to robust scrutiny to ensure the best use of those funds.

The loan financing from Big Society Capital is repayable and therefore Due Diligence is necessary to ensure a thorough examination of **whether it is likely the loan will be repaid** and that **impact will be achieved**.

As a result, the governing documents and contracts of The Growth Fund all require Due Diligence to take place to ensure that the funds are being used responsibly and for the purpose for which they were intended, **without taking undue risk**.

What are the areas due diligence examines?

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- The Due Diligence process explores further 6 key themes:

1. The market gap the proposal is addressing
2. The proposed solution
3. The social impact of the proposal
4. The ability of the social investor to deliver the proposal
5. Financial and social risks at each level
6. The wider benefits to the market

These themes are explored in the Business Plan – due diligence attempts to better understand the proposal, the social investor's ability to deliver the proposal and the feasibility of what they propose, in a structured way.

- Following the initial review of the Business Plan by JIC, they may request certain aspects of the proposal are explored in more detail and specific questions are addressed during the due diligence process.

- There are also a number of generic factors a due diligence covers (via the completion of a Due Diligence checklist), which are detailed in the 4 categories below. These include exploring further the governance of the organisation and the systems in place to deliver the proposal.

CORPORATE GOVERNANCE

For example, this might consider (at a minimum):

- If the social investor is legally able to deliver the Growth Fund
- Whether the social investor has appropriate governance in place? (e.g. functioning Board, Audit committee, conflict of interest policy etc.)
- If the social investor has the necessary insurance in place?
- A review of audited annual financial statements

DELIVERING THE GROWTH FUND

For example, this might consider (at a minimum):

- The experience of the social investor (& partners) in making investments or grants into charities and social enterprises
- The financial model and assumptions in more detail
- Their understanding and assessment of the eligibility criteria
- How the social investor understands and deals with State Aid
- Evidence of the demand and pipeline for investments

INVESTMENT & GRANT MAKING, MONITORING SYSTEMS

For example, this might consider (at a minimum):

- What investment and grant assessment, making and monitoring processes are in place?
- The composition and functioning of the Investment Committee
- What policies and processes are in place for poor performing investments or those at risk of default
- Thought given to the social outcome areas of the proposal and the plans to measure this
- Whether the social investor will meet the reporting requirements

OTHER SYSTEMS FOR GROWTH FUND DELIVERY

For example, this might consider (at a minimum):

- Examination of the IT systems & whether they are fit for purpose
- Financial controls and effective internal and external audit arrangements in place
- Robust policies and systems for the likes of HR, communications, procurement, complaints, equal opportunities etc.
- Robust risk management policies and processes in place
- Effective safeguards to protect public monies

Due diligence practicalities and timelines

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Typical Due Diligence timeline:

	VISIT PREPARATION	SITE VISIT		
Joint Investment Committee (JIC) Initial Round	Access sends the Due Diligence checklist and specific questions from JIC to the Social Investor	Access/BSC visits the Social Investor to discuss the Due Diligence checklist and topics and questions identified in advance. They will seek to obtain any additional information required and further their understanding.	JIC Final Round	Social investor informed of the decision
Aside from generic Due Diligence requirements, the JIC identifies particular areas for DD to focus on	The Social Investor is able to prepare for the site visit, based on the topics and questions sent ahead of time.	Following time spent at the Social Investor, the outcome of the due diligence culminates in an investment proposal back to JIC for a final decision. Further information from the social investor may be required prior to the JIC, depending on the outcome of the site visit.	JIC makes the decision of whether the social investor receives the investment (<u>NOTE</u>: JIC may require additional information or further investigation before deciding)	If a positive decision, it will result in a written offer and trigger the next stage: Signing of the legal documents
	Likely to **take up to 3 days** of the social investors time, although this is applicant dependant	The site visit **typically takes a day** (although this may be spread over a few visits). Time may also be spent after the visit following up on any outstanding information **(1 – 2 days)**		

Typically this will take place over a 6 week period

<u>WHO PERFORMS THE DUE DILIGENCE?</u>

- The Due Diligence is performed by a team from BSC and Access
- BSC and Access work closely to ensure the process runs as smoothly as possible and that the Social Investor feels like they are working with one team (versus two organisations)

What does a typical site visit involve?

- A site visit typically takes one working day and includes a visit from a team from BSC/Access (usually 2 attend). The site visit may occur on a specific day or consist of a few shorter visits over a few days.
- It is a chance for all parties to meet, including those who may be involved in the running of the fund as well as key decision makers.
- It is an opportunity for the due diligence team to discuss, with the social investor, the requirements of the due diligence checklist and the topics and questions that were sent ahead of the visit, together with anything that comes to light as part of the visit.