Impact Investing:
Triodos Experience, Challenges and Trends

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Triodos is a global pioneer of sustainable banking and impact investment. Its mission is to make money work for positive social, environmental and cultural change.
Impact Investing has the potential to unlock significant sums of private investment capital to complement public resources and philanthropy in addressing pressing societal challenges.
Impact investing can bring scale and response to societal needs by unlocking resources additional to traditional philanthropy.

Whitni Thomas

Triodos Bank has been at the heart of investing for positive social and environmental change for over 30 years, pioneering among other things investment in renewable energy and microfinance, both now recognised as asset classes in their own right. Here in the UK, we currently have more than £500m lent to social and environmental organisations. In 2008 we launched and managed the UK's first social enterprise investment fund, before concluding in 2010 that the market wasn't ready for this type of fund. Since 2011 we have focused on the capital needs of social and environmental organisations themselves and have raised more than £55m of investment for organisations like Cafédirect, Midlands Together, St Mungo's and Greenwich Leisure through bespoke capital raises. With the benefit of our long track record in impact investments, we've been asked to offer a few reflections on the UK social investment sector.

Social investment is not the same as funding for the third sector.

Harvey McGrath – the chairman of the Big Society Capital board – recently pointed out that social investment isn't a silver bullet for the third sector. Social investment indeed isn't right for many third sector organisations. Yet the general discussion around social investment continues to conflate it with funding for the third sector. The two are not the same. Agree with it or not, the discussion around social investment today – and especially impact investing – is mainly about social investors and their needs. These don't always match the requirements of the charity and the social enterprise sector.

Of course social investors aren't meaningful in isolation without the vibrant and ambitious social change organisations they invest in. Discussion of social investment should take much more into account the actual funding needs of social change organisations; otherwise the social investment sector will end up being a vacuous and overhyped term if this well-meaning money never finds a home. We certainly don't need another debate around terminology, but it is important to be clear that social investment is not shorthand for funding the third sector.

It's (still) tough to make the fund model work in the third sector.

Funds can be an efficient way to allocate capital to a sector by entrusting an expert to do the job for you. Triodos itself is a fund manager with €2.5bn assets under management and we managed a social enterprise fund for two years before concluding that the pipeline wasn't there to justify an equity type social enterprise fund. At this point one can either hope for the market to come to you in time (the 'if you build it, they will come' school of thought) or adapt what type of finance one is offering to meet the needs of the target market. We actually chose to focus on the organisations seeking capital themselves and make them our starting point – and our clients – thus building our corporate finance advisory business.

There are inherent challenges to fund structures when one is trying to invest in a fragmented market, such as the third sector. Investment sizes inevitably drift upwards to mitigate transaction costs. Most social investment funds won't invest less than £250k and many would much prefer to invest in £500k to £1m chunks. The supply of investible social enterprises has improved since we were trying to invest but it is still limited especially at the larger end of the scale. The costs of running a fund even by a socially minded fund manager tend to be high as a proportion of the typically small size of social investment funds (£10m to £20m). Most management fees in this sector are somewhere around 3% p.a. which some investors or potential investors are becoming wary of. These fees, necessary to run a fund, inevitably push up the cost of capital from these funds, sometimes to a level which is or seems unpalatable for the social organisations.

The recent launch of two new funds focused on unsecured lending is refreshing as they should be a better match for a lot of the demand in the sector. However the return expectations of these funds will continue to make deal doing slow. Many of our charitable clients have an expectation and a business model that can only support a cost of capital in the 4% to 6% range. So in addition to finding mechanisms to get smaller deals done (sub £150k), we also need to find ways of making a different type of capital available for smaller, unproven organisations that would benefit from funding more akin to a repayable grant rather than a loan or quasi equity. Some leading lights in the sector have been experimenting with this for years and we need more of them. The challenge is how to build a sustainable business model for this type of intermediary.

Direct investment is making social investment accessible to 'everyday' investors.

Over the last ten years, some of the more innovative charitable trusts and foundations have been instrumental in helping social enterprises and charities to grow by lending them capital in instances where banks deemed it too risky to do so. Social business angels have also played an important role in helping to get social organisations to the next stage of their growth. But what has been especially heartening in the last year has been the rise of the 'everyday' social investor. In 2013 we raised £18m of capital for two charities and one social enterprise and over half the amount raised came from individual investors.

In our experience, individual investors are willing to take a slightly reduced financial return for an investment perceived as relatively safe in a social organisation with a well-articulated social impact. Our investors don't seem as concerned about forgoing some financial return if they believe the investment is sound and the risk of capital loss is minimal. These are individuals who want to use some of their savings or investments to enable positive change and seek a sense of connection with what their money is invested in.

The beauty of direct social investments like charity bonds is that the starting point is the charity or social enterprise itself. We work with our clients to understand their business model and advise on what type of investment may be – or in many cases may not be – suitable and then do our upmost to raise the capital they need on the best terms possible. It isn't always economical to do direct capital raises of a small size so we are encouraged by the soon-to-be launched

Big Potential which we hope will replicate the success of the Investment and Contract Readiness Fund, while focusing on meeting the needs of smaller charities and social enterprises[1] .

Social impact bonds can be powerful where they enable new interventions to take place.

Payment by results commissioning and the social impact bonds used to finance the contracts are an intriguing development in the sector. Even though none of the SIBs have matured, much can already be learned about how to drive better commissioning, how to structure and run them. The challenge is that almost all SIBs are unique to an extent and setting them up is resource intensive. They are also vulnerable to shifts in government policy as the recent developments in the Peterborough SIB illustrate.

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The social investors we speak to find social impact bonds most appealing when they enable interventions which wouldn't happen otherwise; for example by speeding up the rate at which children are adopted. Many charitable trusts and foundations aren't as interested in SIBs where they believe that they are effectively providing working capital for running social programmes which the government used to fund. This is quite an inefficient use of capital in any case, as the government can borrow at a much lower rate than the cost of capital of a typical SIB.

Social impact bonds are really at their best when they enable genuine innovation in service delivery particularly where they relate to preventive services leading to better outcomes for vulnerable individuals, while saving taxpayer money over the long run. We believe the market will continue to grow but it takes a lot of time, effort and coordination from various stakeholders for these programmes to come together.

Social investment, what next?

Social investment is attracting a lot of attention at the moment, which is welcome as we need new investors into the sector. Some of the pioneer social investors are starting to pull back as they feel like they have 'done their bit' to help grow the market. The increasing interest from mainstream asset managers is encouraging though there still is a gulf to bridge between their expectations of investment size, risk, liquidity and market conforming rates of return and the reality of what social investment products can and should offer. We need to continue to work to balance the needs of prospective investors with the type of capital that social change organisations need to access in order to continue to deliver tangible, lasting social impact.

[1] The Investment and Contract Readiness Fund is a fund dedicated to helping charities and social enterprises acquire the skills they need to raise investment and compete for public service contracts.