UK Catalytic Capital

GROWING PROVISION | CATALYSING IMPACT

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THE CHANGE COEFFICIENT

BIG SOCIETY CAPITAL

ACCESS The Foundation for Social Investment

ACF Association of Charitable Foundations

Foreword by Amir Rizwan

Relationships Director, Big Society Capital

Catalytic capital has played a vital role in the development of the UK social investment market to date and has been pivotal in supporting the growth of the social investment market from £833m in 2011 to £7.9bn in 2021.

At its core, catalytic capital aims to unlock impact and draw in additional investment that would not otherwise be possible resulting in the strengthening of communities and seeding and growing social innovation using multiple tools and approaches. Its usages in the UK have been multifaceted and have included the use of subsidies, guarantees, blended finance structures, and concessionary risk-tolerant investment. The flexibility of this capital and the differing interactions that stakeholders have with it is a key challenge in talking about catalytic capital in the context of the UK. This report seeks to lay the beginning of more nuanced conversation about the usage and best role that catalytic capital can have within the UK social investment market.

Given the important nature of catalytic capital, Big Society Capital, and Access - the Foundation for Social Investment have come together to commission this piece of research alongside the Association of Charitable Foundations. This research report is the first in-depth study on the usage of catalytic capital in the UK and aims to provide insight into the opportunities and challenges that exist when it comes to improving access and growing the supply of catalytic capital here in the UK. This report has engaged over 70 different stakeholders from a wide variety of backgrounds to develop a series of recommendations on how we can improve the provision and understanding of catalytic capital here in the UK as well as begin to come to a position of developing a UK approach towards catalytic capital. It has also engaged with and investigated international examples and initiatives as a way of bringing in vital lessons from around the world on how catalytic capital has been used to further the opportunities for learning here in the UK.

This report has set out to conduct an in-depth literature review of both UK and international examples of catalytic capital and to review catalytic capital funds and notable investments in the UK and internationally to better understand catalytic capital in a UK context. Following this it then looks at the best uses of catalytic capital and where barriers exist and recommendations on how we can increase the provision of catalytic capital. Due to the constraints within this research report the focus has been on looking at the delivery of social impact and not fixating on legal structures as well as focusing on the role investments and investment structures. This, alongside the methodolgy used has all been outlined further within the report.

We hope that this report begins several conversations on catalytic capital here in the UK as well as serves as an impetus for cross-sector collaboration on how we can grow the provision of this vital investment here in the UK. As well as developing a common understanding of catalytic capital this report aims to sets in motion a much-needed conversation around how we can grow its provision as well as provide an opportunity to engage with stakeholders from trusts and foundations to government around how the learnings and recommendations of this report can be picked up and taken further. This is the right time to be having this discussion on catalytic capital given all the various streams of work taking place on this topic across the world and the further need for catalytic capital to play a vital role during a period of economic uncertainty. We hope that this report adds to the important discussions taking place and is the first step towards much-needed tangible solutions to grow the provision of catalytic capital here in the UK.

UK Catalytic Capital

Executive Summary

Executive Summary

The What

We define catalytic capital as:

"investment into social purpose organisations and/or funds that is patient, risk-tolerant, concessionary, and flexible (or some combination thereof) in ways that can fill persistent capital gaps faced by social purpose organisations and social impact investment fund managers seeking new markets and attracting new capital."

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The relatively simple definition of catalytic capital belies a complex range of approaches, investing instruments and target outcomes.

We have adapted the MacArthur Foundation definition of catalytic capital for use in the UK to reflect feedback from seventy stakeholders. We define catalytic capital as "investment into social purpose organisations and/or funds that is patient, risk-tolerant, concessionary, and flexible (or some combination thereof) in ways that differ from conventional investment". As the definition highlights catalytic capital can be deployed directly into social purpose organisations, or, as wholesale investment to support the establishment and development of social investment fund managers and markets. Of the four key descriptors of catalytic capital, the case studies, interviews and research conducted have shown that concessional and risk tolerance has come up as the most important requirement for social purpose organisations and social investment fund managers.

The Why

Catalytic capital

can fill persistent access to capital gaps faced by social purpose organisations and social investment fund managers seeding new markets and attracting new capital.

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Catalytic capital can have a transformative impact at scale, by filling persistent access-to-capital gaps faced by social purpose organisations and social investment fund managers and seeding and developing new social investment markets.

Access-to-capital gaps faced by social purpose organisations and social investment fund managers include insufficient provision of investment, limited provision of smaller investments and support for the provision of smaller investments, investment for innovation, research and development, early-stage social purpose organisations, new investment products and new fund managers, affordable investment, and investment that seeks to improve systemic challenges around inclusion (particularly for Black and Minoritised ethnic-led social purpose organisations). In meeting these access-to-capital gaps, catalytic capital can seed new markets and attract significant volumes of new capital into the social investment market.

The How

part one

A pool of concessionary capital is often needed to structure catalytic capital funds or investments.

Concessionary capital, defined as capital able to take a lower-than-market-rate return for a given level of risk, can be deployed directly as catalytic capital or blended with market-rate return capital and/or with non-concessionary catalytic capital to create catalytic capital funds or investments. The mechanisms that could be used to structure catalytic capital funds or investments include grants, subordinated investment and first-loss capital, tax relief such as Social Investment Tax Relief, and guarantees. Providers of concessionary capital include, among others, government, foundations and high-net-worth individuals

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part two

Catalytic capital can be deployed through a range of investment instruments.

Equity[1] and quasi-equity is inherently patient and risk-tolerant investment instruments, and are therefore seen as a natural fit for the deployment of catalytic capital. However, any investment instrument can be used to deploy catalytic capital, including debt, equity, quasi-equity, impact-linked investments, and mixed instruments where grants are deployed alongside repayable investment. Interviews and case studies also highlighted that the way investments are managed is as important as the terms of the instrument, in ensuring catalytic capital is patient and flexible.

*Jump to **page 38** to read more.*

The How Much

A potential annual market gap of

£189m to £480m.

Jump to page 43 to read more.

While there are pockets of catalytic capital provision in the UK, we estimate a catalytic capital funding shortfall for investment directly into social purpose organisations of around £200m annually.

Our calculations suggest the need for £287m to £578m of catalytic capital provision per year. If we assume a current catalytic capital provision directly into social purpose organisations of £98m, this implies a potential market gap of £189m to £480m. Given significant gaps in the dataset and the fact that new supply will undoubtedly drive an increase in demand, these numbers are highly indicative. That said, the scale of potential demand highlights the need for greater provision. At the wholesale level it is harder to estimate demand as wholesale catalytic capital seeds new markets and investment products. That said, data from Big Society Capital highlights the scale of the opportunity. Since inception, Big Society Capital has made £700m of catalytic capital investments and acted as the cornerstone investor in 44 social investment funds. Over this period the social investment market has grown from £830m in 2011 to £7.93bn at the end of 2021. While we cannot quantify the exact leverage of Big Society's Capital it is clear the £700m has been instrumental in attracting new sources of capital to the market.

Figure 1: Summary of catalytic capital – the what, why and how of catalytic capital

<table>
<tr><th>The What</th><th>Catalytic capital is investment that is one or more of …</th><th>Patient</th><th>Flexible</th><th>Concessionary</th><th>Risk tolerant</th></tr>
<tr><td rowspan="2">The Why</td><td rowspan="2">Catalytic capital addresses access to capital issues for social purpose organisations and social investment fund managers and delivers impact by growing and broadening the social economy.</td><td colspan="4">Affordability – expanding the breadth and depth of social purpose organisations. Innovation, research and development, early stage venture funding. New investment products and new social investment fund managers.
Inclusion – expanding the uptake of social investment by organisations developed and run by diverse groups as well as for solutions looking to grow impact within diverse communities.</td></tr>
<tr><td colspan="2"></td><td colspan="2">Insufficient funding (leverage market rate capital)</td></tr>
<tr><td rowspan="6">The How</td><td rowspan="2">Market rate capital is made concessionary and risk tolerant through a range of structuring mechanisms [Part 1] …</td><td colspan="4">Grants – the use of grant funding to act as either a first-loss layer, subsidy or technical assistance
Tax relief – the use of tax mechanisms to bring in new investors.</td></tr>
<tr><td colspan="2"></td><td colspan="2">Guarantees
Subordinated investment
– first loss.</td></tr>
<tr><td rowspan="4">& Patient, risk tolerant, flexible and/or concessionary capital is deployed through a range of instruments [Part 2] as …</td><td colspan="4">Debt – unsecured debt, debt with lower than market interest rates and/or repayment holidays and debt paid over an extended period.</td></tr>
<tr><td colspan="4">Equity and quasi equity – non-withdrawable debt, withdrawable equity, revenue participation agreements.</td></tr>
<tr><td colspan="4">Mixed funding models – grants deployed alongside repayable finance.</td></tr>
<tr><td colspan="4">Impact linked instruments – impact linked loans, success notes.</td></tr>
</table>

Source: The Change Coefficient

The Why Not

A lack of concessionary capital is the biggest barrier to increased deployment of catalytic capital.

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This is driven by a range of underlying factors including:

- No common understanding of catalytic capital and its role in the wider investment market.
- Significant competition for concessionary capital.
- Uncertainty over who should be providing catalytic capital.
- Trust deficits and concerns about concessionary capital funding private gain.
- Lack of data and evidence on the value case for catalytic capital, both in financial terms and in terms of the social and environmental impact.
- Lack of co-ordination around the provision of catalytic capital.
- Potential lack of market capacity to deploy catalytic capital effectively and efficiently.
- Unhelpful framing of catalytic capital in the language of subsidy.
- A misalignment between funding approaches and the way catalytic capital is typically structured; providers of concessionary capital tend to fund impact areas, whereas current catalytic capital provision tends not to focus on particular outcome areas.

To address these barriers, we have summarised our recommendation into five categories:

1. **Raising awareness of catalytic capital – market building.**
2. **Building the evidence base.**
3. **Creating structures to ensure the effective deployment of catalytic capital.**
4. **Leveraging the experience of outcome contracts and Social Impact Bonds.**
5. **Showcasing the impact potential of catalytic capital.**

The table below details the recommendations within each category, target outcomes for each recommendation and the barriers addressed. Barriers are repeated where they are addressed by more than one recommendation.
We have resisted assigning recommendations to target stakeholders, in the hope of driving greater collaboration.

Table 1: Recommendations to grow the UK market for catalytic capital and ensure the effective deployment of catalytic capital

Category	Recommendations	Target outcomes	Barriers addressed
1. Raising awareness – market building	• Large-scale annual catalytic capital conference with all stakeholders represented in volume. Panels to showcase catalytic capital deals and funds, case studies from social purpose organisations and social funds that have benefited from catalytic capital highlighting the impact of catalytic capital, and workshops to highlight best practice, particularly around impact reporting, investment decision-making, governance and portfolio management. Roundtables to create opportunities for collaboration. • Publication of an annual market survey detailing existing and planned deployment of catalytic capital broken down by target returns and funding mix, sector/impact focus, geography and access to capital gap(s) addressed.	• Increased awareness and understanding of catalytic capital. • Improved co-ordination and understanding of market activity. • Improved understanding of the need for catalytic capital and its impact on social purpose organisations and social investment fund managers. • Improved identification of gaps in the provision of catalytic capital, particularly across the return spectrum of 0-102% return of capital. • Improved co-ordination and the pooling of larger volumes of concessionary capital. • Catalytic capital established as a distinct approach to investing in social purpose organisations.	No common understanding of catalytic capital. Lack of co-ordination. Uncertainty over who should be funding catalytic capital. Lack of data. Competition for concessionary capital.

Category	Recommendations	Target outcomes	Barriers addressed
2. Building the evidence base	• Development of a standardised dataset to be completed by catalytic capital providers and published in the annual catalytic capital report. The dataset would focus on the impact of catalytic capital on the social purpose organisations funded, e.g. growth in revenues, growth in numbers of people reached, and not seek to standardise outcome metrics across social purpose organisations and funds. • Improved data collection on social purpose organisations in general at both local and central government levels.	• Improved understanding of the impact of catalytic capital on social purpose organisations and their service users/beneficiaries. • Improved understanding of the social and economic value created by social purpose organisations. • More stakeholders are encouraged to provide the concessionary capital needed to deploy catalytic capital (particularly government). • Improved efficiency in the deployment of catalytic capital through the identification of what is and isn't working.	Lack of data. Trust deficit. Focus on impact.
3. Ensuring effective deployment of catalytic capital	• Ensure catalytic capital provision across the return spectrum. • Catalytic capital investment committees to have a balance of social entrepreneurs and those with finance or corporate backgrounds. • All catalytic capital funds to have measures in place to ensure other investors are not crowded out by their provision of catalytic capital (e.g. evidence that investees could not get capital elsewhere). • Evidence requirements on the potential impact of the catalytic capital investment on both the social purpose organisation/fund and its service users/beneficiaries ahead of any investment decision. • Fund managers to be adequately funded to provide the hands-on investment management required to ensure catalytic capital is sufficiently flexible during the life of the investment where appropriate. • Increase funding to fund managers already effectively deploying catalytic capital.	• Catalytic capital meets the needs of social purpose organisations driving growth and sustainable social impact. • Catalytic capital addresses critical access to capital gaps for social purpose organisations. • Catalytic capital is flexible enough to adapt to changing market conditions. • Impact is at the heart of decisions around the deployment of catalytic capital driving efficient allocation of catalytic capital.	Market capacity to deploy. Trust deficit.

Category	Recommendations	Target outcomes	Barriers addressed
4. Leveraging the experience of outcome funding instruments	• Explore mechanisms to encourage local authorities and others to provide catalytic capital, alone or in partnership with social investors, with concessionary capital funded through potential cost savings or cost avoidance. • Explore how outcome metric triggers on investments can increase the provision of catalytic capital to social purpose organisations, by linking concessionary rates, risk tolerance, flexibility and/or patience directly to social outcomes.	• More concessionary funding is secured for deployment as catalytic capital. • Shift the narrative from investments where there is some loss of capital, to impact funding with significant return of capital. • Shift the narrative from subsidy to impact generation.	Language of subsidy. Competition for concessionary capital. Focus on impact. Lack of co-ordination.
5. Showcasing the impact potential of catalytic capital	• Development of a fund with the remit to absorb highly concessionary returns, as required, focused on solving a large-scale social problem such as children's care, where for-profit, private equity backed companies are delivering poor outcomes and poor value for money.	• Attract more concessionary funding for deployment as catalytic capital, by linking funding directly to outcomes and showcasing the power of catalytic capital. • Social purpose organisations are inspired to explore the potential of catalytic capital to support their growth plans. • Create a model for effective collaboration, particularly between the providers of concessionary or risk-tolerant catalytic capital and those seeking closer to a market rate of returns.	Focus on impact. Competition for concessionary capital. Trust deficit.

UK Catalytic Capital
Main Report

Approach and Methodology

The Change Coefficient, a social impact and investment advisory working in the UK and internationally, was commissioned by Access - the Foundation for Social Investment, Big Society Capital (BSC) and Social Impact Investors Group (hosted by the Association of Charitable Foundations) to explore catalytic capital in a UK context and how more catalytic capital can be unlocked. This report is intended to kick-start a conversation about catalytic capital in the UK, and is the first step in a larger engagement process that aims to:

1. Develop a common understanding of catalytic capital in the UK.
2. Showcase successful catalytic capital funds and investments.
3. Identify barriers to the deployment of greater volumes of catalytic capital in the UK.
4. Make recommendations to support the growth of the UK catalytic capital market (kick-starting the conversation with this first phase rather than providing a definitive roadmap).

Growing the UK catalytic capital market will require greater pools of concessionary capital. *Effectively* growing the catalytic capital market, to maximise long-term social impact, will require cross-sector collaboration. Developing a collaborative funding eco-system is therefore essential.

We have accordingly written this report with, and for, the widest range of possible social economy stakeholders, including:

- Central government,
- Corporates,
- Commercial investors – including pension funds and others,
- Foundations,
- Fund managers,
- High-net-worth individuals and private wealth managers,
- Impact investors,
- Local government,
- Retail funders,
- Social purpose organisations.

The preparation of this report involved the review of a broad range of relevant literature including, but not limited to, research on the UK and international social investment and impact investing markets, research from the Catalytic Capital Consortium (C3)[2] and its partners on catalytic capital, research on blended finance, research on funding for SMEs, and research on development financing initiatives by development finance institutions. This was followed by a review of catalytic capital funds and notable investments in the UK and internationally, as well as stakeholder interviews. Seventy individuals were interviewed, of whom 90% are UK-based (the full list of interviewees can be found on page 17).

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All interviewees were asked the following questions in addition to more targeted questions based on their expertise and experience:

- How do you define catalytic capital in a UK context?
- What should catalytic capital be used for?
- What are the barriers to the deployment of greater volumes of catalytic capital?
- What would encourage you to engage more with the catalytic capital market (i.e. provide concessionary capital or deploy catalytic capital)?
- What do you think should be done to grow the provision of catalytic capital?
- What are good examples of catalytic capital funds or deals?

The interviews were followed by a data review. Market-level and fund-level data was considered, as well as data from surveys such as the SEUK State of Social Enterprise Survey.

Report boundaries

Focus on impact, not legal structures – in this paper we focus on the delivery of social impact and do not distinguish between the various legal structures – including but not limited to companies limited by shares, community interest companies and public benefit societies. We acknowledge the argument that some legal structures and forms may generate disproportionate economic and social value[3] and accept there are challenges enshrining mission in others. That said, our research highlighted the myriad ways asset owners and investors are ensuring long-term impact through their investments. Furthermore, in some cases, the ability to invest in a wider range of entities is a critical component of delivering impact at scale. In this paper we therefore refer to social purpose organisations, which encompasses both for-profit and not-for-profit mission-driven enterprises.

Facilitating investment, not revenues – improving access to investment, while being the focus of this report, is just one of many tools used to support the growth of social purpose organisations. For example, tightening rules around social value in public procurement, promoting 'social buying'[4] through campaigns, and tax breaks on VAT for products and services from accredited social purpose organisations, would all serve to grow the social economy by boosting the revenues of social purpose organisations. We do not explore such tools in this paper, but note investment is always dependent on vibrant end markets.

Technical assistance – the value of funding technical assistance and support to investees, was highlighted by interviewees and the research. Technical assistance, it is argued, is needed to support investment pipelines and the long-term growth of investees. We found conflicting evidence as to the volume of latent demand for investment, as opposed to the volume of demand that would need further support to take on investment. Given this uncertainty, the availability of funding such as the Reach Fund[5] and other means of providing technical assistance and support will be critical in bridging demand gaps in the medium term, and potentially supporting catalytic capital provision.

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Approach and Methodology

The Change Coefficient was founded to facilitate the growth and effectiveness of the social economy. We are a social impact and investment advisory working both in the UK and internationally. Our team brings experience of fund management, growth consultancy, research and investment raising as well as social enterprise incubation and management. We support the design and development of social economy market infrastructure from both a revenue and an investment perspective. We work with, and understand, the widest range of stakeholders, from social purpose organisations and government to commercial investors seeking to invest in the social economy.

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Interviewees

Andy Schofield, *Curiosity Society*
Anita Bhatia, *Guy's and St Thomas' Foundation*
Anne Lythgoe, *Greater Manchester Combined Authority*
Anoushka Amin, *CAF Venturesome*
Ben Lane, *Arts Council England*
Ben Rick, *Social and Sustainable Capital*
Charlotte Hollins, *Fordhall Farm*
Chris West, *Sumerian Partners*
Claire Spencer, *West Midlands Combined Authority*
Daisy Ford-Downes, *Firstport*
Dan Gregory, *SEUK*
Daniel Brewer, *Resonance*
Danyal Sattar, *Big Issue Invest*
Dario Parziale, *Toniic*
Dave Thornett, *Key Fund*
David Bartram, *UnLtd*
David Neaum, *New Philanthropy Capital*
Denise Holle, *Joseph Rowntree Foundation*
Dominic Burke, *Lankelly Chase Foundation*
Felix Litzkow, *Crisis Venture Studio*
Fran Sanderson, *Nesta*
Gail Cunningham, *Social Impact Investors Group* (hosted by the Association of Charitable Foundations)
Gary Miller, *GMCVO*
Gemma Rocyn Jones, *The National Lottery Community Fund*
Gianluca Gaggiotti, *EVPA*
Gillian Dickson, *Esmée Fairbairn Foundation*
Graham Phillips, *Norfolk County Council*
Hannah Hoare, *The Blue Thread*
Harrison Coldray, *Department for Digital, Culture, Media & Sport*

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Harry Davies, *Ceniarth*
Harvey Koh, FSG
Heather Matranga, Village Capital
Holly Piper, Fair4All Finance
Inez Mikkelsen-Lopez, Asian Development Bank
Isabelle Irani, Sumerian Partners
Jack Goldstein, Skagen Conscience Capital
James Potter, Big Issue Invest
Jem Stein, The Bike Project
Joe Ray, People's Postcode Lottery
Jonathan Jenkins, London's Air Ambulance Charity
Josiah Lockhart, Firstport
Kevin Osborne, Create Equity
Laura Gilbert, Greater London Authority
Lisa Ashford, Ethex
Mark Atterton, formerly of Reall
Mark Lovell, The Social Assistance Partnership
Mark Stamper, North of Tyne Combined Authority
Martin Wood, North of Tyne Combined Authority
Mathu Jeyaloganathan, UnLtd
Matthew Bowcock, The Beacon Collaborative
Matthew Roche, The Mercers' Company
Melanie Mills, Big Society Capital
Mila Lukic, Bridges Fund Management
Nick Temple, Social Investment Business
Nicola Saunders, Arts Council England
Oliver Pollard, Resonance
Oluwaseun Soyemi, The National Lottery Heritage Fund
Pauli Platek, Department for Digital, Culture, Media & Sport
Peter Cafferkey, EVPA
Ray Hughes, Wellington Orbit
Richard Harris, Institute for Community Studies/ The Young Foundation
Sarah Faber, The Young Foundation
Seb Elsworth, Access - the Foundation for Social Investment
Stephen Bediako, The Social Innovation Partnership
Susan Aktemel, Homes for Good
Tim Coomer, Co-operative & Community Finance
Tim Davies-Pugh, Power to Change
Toby Eccles, Social Finance
Trace Welch, The ImPact
Vanessa Morphet, The Archbishops' Council

The Steering Group

Alison Jeffrey, *Department for Digital, Culture, Media & Sport*
Amina Ahmad, *Village Capital*
Amir Rizwan, *Big Society Capital*
Gail Cunningham, *Social Impact Investors Group (hosted by the Association of Charitable Foundations)*
Gemma Rocyn Jones, *The National Lottery Community Fund*
Matthew Bowcock, *Beacon Collaborative*
Pauli Platek, *Department for Digital, Culture, Media & Sport*
Peter Babudu, *Blagrave Trust*
Seb Elsworth, *Access - the Foundation for Social Investment*
Stephen Bediako OBE, *The Social Innovation Partnership*
Stephen Muers, *Big Society Capital*
Susan Aktemel, *Homes for Good*

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Section 1.

Defining Catalytic Capital – The What

1. Defining Catalytic Capital – The What

The last two decades have seen significant development in the UK social investment market.

The sector has grown to £7.9bn in 2021, up from £833m in 2011[6] and is attracting new sources of capital and has developed new markets including impact venture investment, charity bonds, property funds and social outcome contracts. The number of social investment fund managers managing more than £50m has also increased, highlighting the increasing maturity of the market. Yet, in recent years, calls for change to the social investment market have increased[7], amidst frustration social investment is not reaching those who most need it.

Reasons for the make-up of the social investment market and the challenges it faces are complex and multifaceted. Yet, at their root is one fundamental economic reality – **delivering social impact and positive financial returns is challenging**. Many social purpose organisations operate in markets with significant market failures. Social purpose organisations may also struggle to fully monetise their social benefits or positive externalities within existing market and regulatory structures. These challenges dampen returns and increase perceived risk, particularly to those investors less familiar with the operations and end markets of social purpose organisations. Catalytic capital, which includes some forms of social investment and venture philanthropy, is being explored both in the UK and internationally as a potential solution.

Figure 2: UK social investment market split 2021
Outstanding investment £m

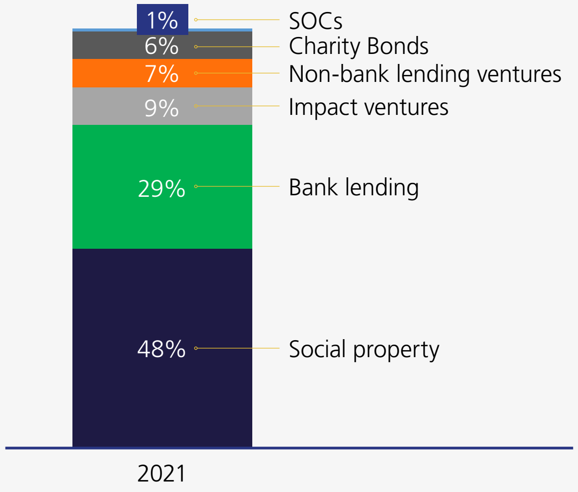
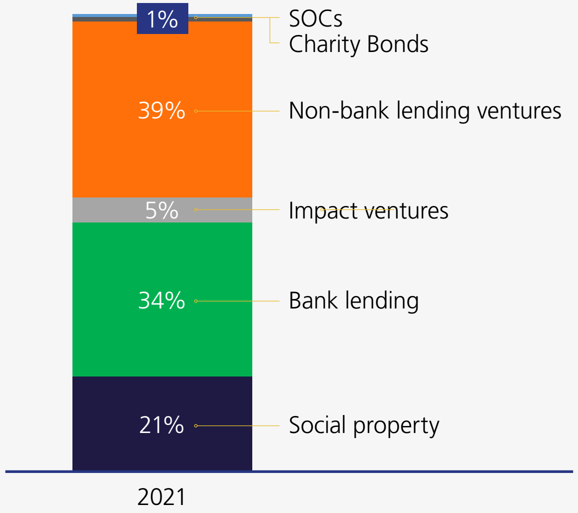


Figure 3: UK social investment market split 2021
Outstanding investment no of investments



Sources: Big Society Capital

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1. Defining Catalytic Capital – The What

"Catalytic capital is investment into social purpose organisations and/or funds that is patient, risk-tolerant, concessionary and flexible (or some combination thereof) in ways that differ from conventional investment." Catalytic capital fills critical access to capital gaps faced by social purpose organisations, accelerating impact and attracting additional resources to the social sector."

'Based on interviews with seventy stakeholders we have adapted The MacArthur Foundation definition of catalytic capital to include an explicit focus on social purpose organisations and social impact funds as shown in Figure 4 below.'

Catalytic capital is a broadly defined approach to structuring investment, aimed at improving access to capital for social purpose organisations, and in doing so creating and scaling impact. Improving access to capital for social purpose organisations can be done through direct investment or by supporting new social investment fund managers and/or supporting the development of new investment products.

Catalytic capital encompasses approaches such as blended finance[8] and covers a wide range of structuring mechanisms, such as guarantees, grants and first-loss capital. Catalytic capital can be deployed through any instrument, from simple debt and equity through quasi-equity, to instruments with explicit impact considerations such as impact-linked loans and success notes.

Catalytic capital is a tool for creating and accelerating social impact, and not a good in and of itself. Conversations about catalytic capital should therefore focus on the access-to-capital gaps the tool can solve, and the impact catalytic capital can have. The catalytic capital delivery mechanisms, while important, particularly in attracting new pools of capital, are a means and not an end.

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Figure 4: Definition of catalytic capital and its components

We define catalytic capital as: investment into social purpose organisations and/or funds that is patient, risk-tolerant, concessionary, and flexible (or some combination thereof) in ways that can fill persistent capital gaps faced by social purpose organisations and social impact investment fund managers seeking new markets and attracting new capital."

Investment, in this context, is funding provided to social funds or social purpose organisations, with the expectation that they will deploy it to generate or grow a revenue stream and deliver social impact. It is distinct from grants or other forms of programme funding, where the only expectation is the delivery of social impact. The addition of concessionary later in the definition, allows for the possibility that not all the investment will be returned, thereby distinguishing catalytic capital from both commercial investment and some social investment provision.

Patient capital

Investment that is made on a longer-term time horizon. Based on interviews, patience is considered anything longer than seven years, with the range up to 30 years. The range will vary depending on the stage of the organisation and the nature of the investment.

Risk-tolerant

A risk-tolerant investor is often making investments on faith, taking a forward-looking view of the potential of an investment, whereas a less risk-tolerant looks for evidence of success. For capital to be risk-tolerant, a degree of concessionality is typically required, as investors needs to be able to bear losses or lower-than expected returns. However, risk tolerance is distinct, in that it implies the possibility, but not the expectation, that the investment will generate lower-than-target returns.

Concessionary capital

Investment that can bear reduced rates of return. Understanding the boundaries of concessionary capital is challenging, and open to interpretations around risk. An investment where the investor is expecting to be repaid less than 100% of the original investment, or 100% plus an annual rate of return equal to inflation, is clearly concessionary capital. This is because in real terms the investor is repaid an amount equal to or less than the original investment.

Flexible capital

Characterised by the type of instrument offered, with equity and other forms of risk-sharing instruments considered more flexible than fixed rate debt. While the type of instrument is an important element of flexibility, it is by no means the only element. Flexible capital is best described as investment that is responsive to the financial needs, and operational realities, of investees during every phase of the investment process.

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1. Defining Catalytic Capital – The What

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Analysis of catalytic capital funds and deals, interviews and desk research suggest that of the four key descriptors of catalytic capital highlighted, the most important are concessionality and risk tolerance. These two elements were found in almost all case studies researched, and therefore form the foundational characteristics of catalytic capital. Flexibilty and patience, while highly desirable, are nessessary to address some, but not all, access-to-capital gaps. It should also be noted that in some cases, offering patience or flexibility requires concessional funding. For example, providing an extended interest and repayment holiday requires the investor either to charge higher interest rates to recoup the period where no interest was charged, or to accept a lower return over the life of the investment.

Catalytic capital includes some forms of social investment. Social investment, like catalytic capital, can be flexible, patient, risk-tolerant and concessionary. However, what distinguishes catalytic capital is that it can target less than 100% repayment of the investment, enabling greater patience, flexibility and risk tolerance.

1.1 Concessionary capital vs catalytic capital

Given the importance of concessionality within the concept of catalytic capital, many confuse concessional capital with catalytic capital. The two scenarios below highlight the distinction:

1. The entire catalytic capital fund or investment is funded with concessionary capital. CAF Venturesome, which has made over 700 social investments worth £60m+ since 2002,[9] is an excellent example of this approach. CAF Venturesome funds make social investments of £25k to £400k, and source philanthropic capital from individuals and family charitable trusts, corporate charitable foundations, and other grant-making foundations in the form of loans and grants into the funds. CAF Venturesome seeks to maximise the social impact of the loans and grants, by recycling them through multiple back-to-back social investments. Using purely concessionary capital in this way may enable the fund manager to maximise impact, rather than managing for returns.

2. Concessionary capital is combined with capital expecting a market rate of return to create a catalytic capital fund or to deploy catalytic capital directly. The concessionary capital is used to bear a greater share of the risk of the investment or to boost the returns of private market investors, ensuring funding remains affordable and risk-tolerant for investees. One example of this approach is the Growth Fund. The Growth Fund is a £50m partnership between the National Lottery Community Fund and Big Society Capital. The fund is delivered by Access - the Foundation for Social Investment through a range of social investors, who are given a blend of grants and investment capital. The Growth Fund aims to address gaps in the social investment market and support charities and social enterprises across England to grow and create social impact in their communities. Fourteen investment managers (including Big Issue Invest, Resonance, Key Fund, Nesta, GMCVO and UnLtd) deploy the funding as catalytic capital to social sector organisations (see page p86 for case study). This approach ensures greater pools of capital are directed to social purpose organisations, as the concessionary capital attracts capital that requires returns closer to a market rate return.

1. Defining Catalytic Capital – The What

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1.2 Wholesale catalytic capital vs direct catalytic capital investments

Most of the interviewees we spoke to, focused on catalytic capital invested directly into social purpose organisations. However, catalytic capital is also needed at the wholesale level, to support the development of new and growing social investment fund managers and new social investment markets. Wholesale investments are investments made into fund managers who use the capital to invest in social purpose organisations. Given the nature of wholesale investments, they are often less visible than catalytic capital investments made directly into social purpose organisations. There are three scenarios of wholesale catalytic capital:

1. Catalytic capital investment to seed a new fund manager – in this case the wholesale investment is considered catalytic capital, as it is absorbing the risk of an unestablished fund manager. Once the fund manager builds a track record, it is typically able to attract investment from a wider pool of investors.
2. Catalytic capital investment to prove a new market – risk-tolerant capital is needed to prove new markets, where there is uncertainly over the investment thesis of the fund or how investments will perform. This uncertainly could be driven by many factors including, but not limited to, the business model of the social purpose organisations being invested in, the sector, the operating region of the social purpose organistaions, new technologies or new investing instruments.
3. Catalytic capital investment into a fund manager making catalytic capital investments into social purpose organisations – in this case the catalytic capital charecteristics are passed on to the social purpose organisations in the form of patience, flexibility, concessionary returns and/or risk tolerance.

Wholesale investments are investments made into fund managers who use the capital to invest in social purpose organisations.

We note that in many cases, new fund managers operate in new markets, as they bring unique insights and experiences. The distinctions between scenarios 1 and 2 are therefore more for illustrative purposes.

BSC is the largest provider of wholesale catalytic capital to social investment funds in the UK. Since inception, BSC has made £700m of catalytic capital investments, equating to 80% of its entire portfolio. Given BSC's mandate, the organisation's catalytic capital is primarily risk-tolerant rather than concessionary. BSC's investments have helped establish and develop a raft of new social investment fund managers and funds, for example the Fair by Design Fund (case study 10 on page 95), and grown the market for new forms of investing instruments such as charity bonds (case study 11 on page 98). We believe this is highlighted by the recent announcement that Big Society Capital will target overall portfolio returns of 2-4% (net returns after market building costs of 1-2%), not the originally targeted 5-6%. This return target was deemed to be consistent with building a sustainable model alongside providing catalytic capital, to support the development of the social investment market.

Section 2.

Access-to-Capital Gaps Addressed by Catalytic Capital – The Why

2. Access-to-Capital Gaps Addressed by Catalytic Capital – The Why

The goal of catalytic capital is to address access-to-capital gaps for social purpose organisations and social investment funds, thereby supporting the development and scaling of the social economy.

These gaps are limiting innovation in, and growth of, the social economy, and in many cases are likely to persist without new forms of financing.

Throughout our research and interviews there was broad consensus on the range of access-to-capital gaps that catalytic capital can address. However, unsurprisingly, the prioritisation of gaps reflected the activities and programmatic priorities of stakeholders. The gaps identified were:

1. Insufficient capital availability and the need to leverage in additional funding
2. Funding for innovation, research and development and early-stage social purpose organisations/ ventures, funds and new investment products
3. Affordability
4. Small investments
5. Inclusion

Some interviewees argued insufficient capital and funding for innovation, early-stage social purpose organisations, new social investment funds and new social investment products should be the focus of catalytic capital. This is because in these cases the funding is explicitly catalysing something new – new sources of capital and new models for impact. While there is merit to this argument, we believe that to define catalytic capital so narrowly would be a missed opportunity in the UK context. Below we outline each of the access-to-capital gaps in more detail.

2.1 Insufficient capital availability and the need to leverage in additional funding

The MacArthur Foundation states that the aim of catalytic capital is to "Unlock impact and additional investment that would otherwise not be possible… while laying the groundwork for mainstream investors to participate in transformative investments." The foundation's focus on attracting additional investment highlights the first access-to-capital gap: insufficient provision of capital for social purpose organisations and social investment fund managers. The sector faces an access-to-capital gap, as investments either do not generate sufficient returns or are perceived to offer below-market-rate returns, due to their risk profile.

Catalytic capital addresses this in two ways: by focusing on risk and focusing on returns. Risk and return are interlinked and must be considered together. That said, in some cases the focus is clearly on supplementing returns as there is visibility on risk, while in others risk may be more binary and returns are less of an issue:

1. Blending concessionary capital with market rate capital to bridge the gap between the returns required by more commercial investors and the anticipated investment returns of the fund or investment. Here the challenge is primarily one of returns, therefore the need for concessionary capital will not abate over time.
2. Providing more risk-tolerant capital to prove the viability of new products, new markets and new social investment fund managers, and over time attract more commercial capital. This is typically

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2. Access-to-Capital Gaps Addressed by Catalytic Capital – The Why

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done at the wholesale level, where risk-tolerant funders such as Big Society Capital make an investment into a fund to prove the commercial viability of the fund and/or fund manager. In an international context, the impact-first fund manager, Global Partnerships, is an excellent example of this kind of catalytic capital support, with its ninth fund, launched in 2021, benefiting from increased investment from commercial investors as compared to its earlier funds.

2.2 Funding for innovation, research and development and early-stage social purpose organisations

Investments to fund innovation, research and development and early-stage social purpose organisations/impact ventures are considered together, as they all typically carry higher levels of risk and require more patient capital. It is important to note that innovation, in this context, is defined broadly. A small charity seeking investment to develop new, relatively unproven revenue streams would fall into this category, as it is innovating its business model. Equally, many large social purpose organisations do not have internal reserves to reinvest or strong balance sheets against which to borrow, and therefore need access to risk capital much like early-stage ventures. Early stage is also broadly defined and driven by financial and organisational maturity rather than years in operation, consequently some forms of growth financing will also fall into this category.

Early-stage social purpose organisations and investment for innovation and research and development are often exploratory and can have a binary risk profile. While it is possible to distinguish those ideas or ventures with higher probabilities of success – clear product market fit, experienced, well-networked team, strong board and early evidence of success – it is virtually impossible not to suffer capital deterioration in the funding of such projects and ventures.

In commercial capital markets, on which much of the social investment market is modelled, venture funders are compensated for the increased risk through supernormal returns on commercially successful investments. Only two out of ten investments need to work, if successful investments generate returns of more than 10x the original investment. Most social purpose organisations in the UK are unlikely to generate such returns, therefore creating a significant funding gap.[10]

Catalytic capital is the natural solution to this challenge. The concessionary nature of catalytic capital absorbs losses and enables higher risk tolerance. Patience gives social purpose organisations a longer runway to test and build their models and can significantly reduce the risk of failure by enabling the organisation to iterate. Finally, flexibility ensures repayments do not impair the organisation's ability to develop and grow, by taking capital out at critical points in its growth trajectory.

The Arts Impact Fund sought to fill this gap for the arts sector. The fund, managed by Nesta and supported with concessionary capital from Arts Council England, provided the arts sector with capital to develop and grow innovative business models. While some innovative models have been funded, Arts Council England and Nesta commented that its pipeline, and the arts sector, could benefit from even more risk-tolerant capital seeding of very early-stage, high-impact business models.

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In the broader economy, there are many examples of the government providing catalytic capital for innovation and research and development. Innovate UK, the UK's national innovation agency, provides funding, much of which is highly concessionary, to support business-led innovation across sectors, technologies and UK regions. The Innovate UK annual budget will be increased to £1bn in 2024/25[11] as part of the government's ambition to increase UK investment in R&D to 2.4% of GDP by 2027.[12] This and other forms of government funding in innovation and R&D are justified on the basis of economic uplift (new jobs, increased tax revenue), but also, in some cases, social value creation (e.g. government funding into medical research).

International example
Obtaining private sector investment into affordable education can be difficult. In 2014, the Pearson Affordable Learning Fund provided early-stage financing to seed SPARK Schools, a network of private primary and secondary schools in South Africa. This allowed SPARK schools to prove the model and unlocked $15m of investment from 2015 to 2018. More than 10,000 students at 21 schools have benefited from SPARK.

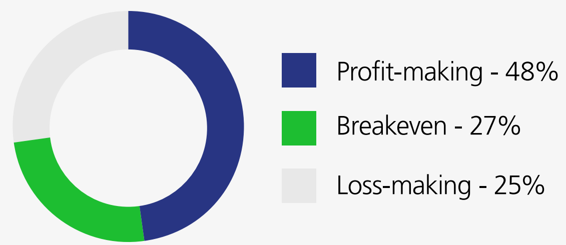
2.3 Affordability

The spectrum of capital is often referenced within the social investment sector. The spectrum spans finance-only return requirements at one end and impact-only return requirements, more commonly known as philanthropy, at the other. While this is a helpful construct, the discourse and funding tend to cluster at the boundaries of the spectrum, rather than operating across it. Funding for social purpose organisations therefore typically falls into one of three categories of financial returns: 1) investment targeting market rate returns, 2) investment targeting sub-market returns on capital but with 100% capital preservation, or 3) investment with no expectation of capital or interest repayment. What is missing is funding with an expectation of some return of capital, but not all. We have marked the approximate scope of catalytic capital and included indicative returns targets in the graphic below. Both are for illustrative purposes only and do not represent firm boundaries.

It is important to note that the cost of capital to the social purpose organisation reflects both the target returns of the investor and the risk associated with the investment, which is a subjective measure. Figure 5 below seeks to classify investments by target returns, which do not reflect the risk premium and therefore the cost of capital to the social purpose organisation. The size of the risk premium will vary from investor to investor, with some more philanthropic funders choosing not to add a risk premium.

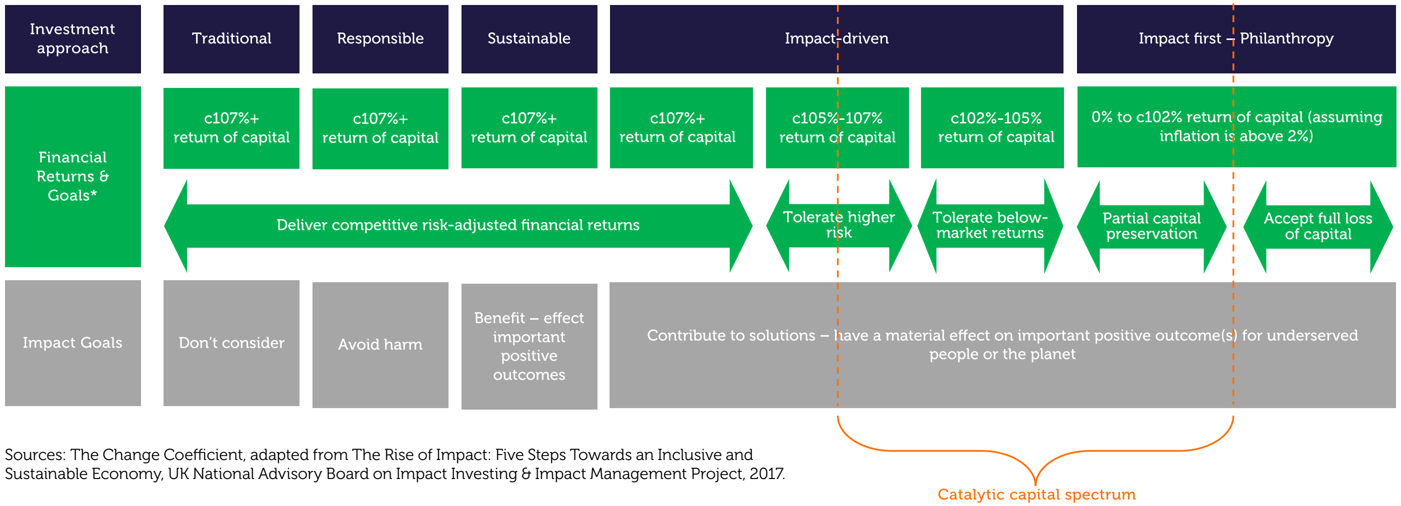
Supplying capital targeting less than 100% returns, or making investments that are more patient, would increase affordability for a wider range of social purpose

Figure 5: Estimated profitability of UK social enterprises, 2019



Sources: SEUK, 2019.

Figure 6: Spectrum of catalytic capital among the total spectrum of capital provided to social purpose organisations



Sources: The Change Coefficient, adapted from The Rise of Impact: Five Steps Towards an Inclusive and Sustainable Economy, UK National Advisory Board on Impact Investing & Impact Management Project, 2017.

*These are indicative numbers and will vary across investors, investments and over time depending on market conditions.

organisations, as the surplus they would need to generate to repay the investment would be lower. This is significant, as profit margins and surplus generation are typically lower in the social sector as compared to the commercial sector – SEUK data from 2019 showed that 48% of social enterprises surveyed made a profit, 27% broke even and 25% were loss-making.[13]

Lower surplus generation is driven by several factors including, but not limited to, the need to keep products and services accessible, thereby maximising impact, higher labour costs due to the employment of people who struggle to access or maintain employment, competing in budget-constrained public service markets, a lack of scale, and a lack of investment in systems and technology.

Social purpose organisations are also often developing new business models and operate in underdeveloped markets that lack effective infrastructure and supply chains. For example, a social purpose organisation setting up a chain of coffee shops run and managed by those leaving prison will have additional costs, as compared to a coffee shop without a social mission. A coffee shop with no targeted hiring criteria can, within minutes and relatively successfully, list on job sites. Conversely the social purpose organisation must reach out to organisations that work with those leaving prison, to ensure they receive applications from their target group. These infrastructure gaps are wide ranging and, cumulatively, increase the work required by social purpose organisations. In India, some social purpose organisations separate their 'social activities' from their 'enterprise activities' in explicit acknowledgement of these additional costs. For example, Sakha Cabs, a social enterprise providing taxis and driving services for women by women, has a separate charitable foundation to recruit and train female drivers.

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Lower surplus generation also directly impacts the pace at which an organisation can repay investment. If we consider the residential mortgage market: access to long-term patient capital is the cornerstone of the mortgage market, with six out of ten mortgages now offering 40-year terms.[14] Were mortgage lengths to be reduced, those with lower disposable incomes would quickly find themselves priced out of the housing market. Catalytic capital addresses affordability gaps, by providing capital that covers the entirety of the impact end of the capital spectrum. That is, capital with an expectation of a sub-market rate of return on capital through to capital with an expectation of no return on capital and only some return of capital. Flexibility and patience are also critical tools in ensuring investment is affordable over time. It should be noted that the question of affordability is often unhelpfully framed in the language of subsidy, with questions of affordability confused with questions about organisational sustainability. Our research highlighted a clear distinction between social purpose organisations requiring ongoing subsidies to cover operating costs, and those where surpluses are generated but are insufficient to repay the investment. The most common example of a sustainable business model that may struggle to repay investment, is the purchase of physical community assets such as community centres or sports assets. This is because the revenue from the asset will cover all the operating costs but may struggle to repay the full purchase price of the asset. The concept also applies to investments in technology, people, products, among other things..

UK example

Futurebuilders addressed the challenge of affordability by offering grants alongside loans, with smaller enterprises receiving a higher proportion of grants (see case study 4 on page 78).

2.4 Small investment

There is a significant body of evidence highlighting insufficient provision of smaller investment amounts both in the UK and globally.[15] The paucity of small investments is in many ways an affordability issue; however, given the demand for small loans, as evidenced by the Access Growth Fund (a partnership between The National Lottery Community Fund and Big Society Capital, delivered by Access through a range of social investors) which provided unsecured loans of <£150k, it is worth acknowledging as a distinct access-to-capital gap. The minimum cost per investment for sourcing, making and managing investments is relatively high. Recouping this cost on small investments is challenging, particularly given underlying affordability challenges in the social economy. As fund managers scale, develop expertise and standardise products, deal costs fall, as highlighted by some of the fund managers we spoke to, including Social and Sustainable Capital (SASC) and Key Fund. However, costs may still not be fully recoverable on small loans. SASC also expressed concern that access to capital should not be solely dependent on a social purpose organisation's ambition and ability to scale, as in some cases scaling social purpose organisations can lead to impact dilution.

Catalytic capital enables fund managers to absorb the higher costs of making smaller investments, rendering them financially viable. Key Fund, a social investor focused on Northern England and the Midlands, and CAF Venturesome, a UK-wide social investor, were two of the earliest funders offering small loans, and continue to be two of the most active in this segment of the market.

2. Access-to-Capital Gaps Addressed by Catalytic Capital – The Why

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UK example
The Growth Fund is set up to support the market provision of smaller loans. The fund supports fund managers with grants to subsidise their operating costs, grants to use as first-loss capital and grants to be used by investees for technical support (see case study 7 on page 86).

2.5 Inclusion

In addition to the generic access-to-capital challenges faced by social purpose organisations, there are well-documented issues around inclusion and access to finance for Black-led enterprises and social purpose organisations led by, or serving, marginalised groups. Analysis by Social Investment Business (SIB) in April 2022 of data from 4,000 organisations, found that Black and Minoritised ethnicity-led organisations are generally smaller in size and have experienced systemic and historic underinvestment. The challenges of inclusion are complex, systemic, and cannot be solved through any single intervention. However, catalytic capital can form part of a wider package of support, enabling more marginalised groups to set up and grow social purpose organisations. This wider package of support may include technical assistance and stipends, to support those without financial or social safety nets make the transition to entrepreneurship.

Social entrepreneurs who face systemic barriers to developing and growing their social purpose organisations, can be effectively supported with capital that is concessionary, flexible, patient and risk tolerant. Concessionary capital can also potentially support higher management fees to cover the cost of providing additional support to investees.

UK example
In April 2022, Social Investment Business (SIB) announced it was utilising £2m of Access grant funding alongside the Recovery Loan Fund to offer more concessionary finance to Black and minoritised ethnicity-led organisations with:

- unrestricted grants alongside loans up to 100% of the loan value as required;
- eligibility for RLF reduced from £400k to £200k turnover;
- the minimum loan size reduced from £100k to £50k.

Addressing capital gaps for social purpose organisations – a short-term imperative or a long-term necessity?

Calls for patient, risk-tolerant, concessionary and flexible capital for social purpose organisations is not new. Indeed, over a decade ago, prior to the establishment of Big Society Capital, the government funded catalytic capital funds including the Adventure Capital Fund (Office for the Deputy PM), Futurebuilders (HM Treasury/Home Office) and the Social Enterprise Investment Fund (Department of Health). Together these deployed over £200m in investment.[16] It was hoped these funds would create a model for the market and attract more commercial capital. However, the evolution of the market, evolution of international impact-first investing markets, and evidence from analogous markets such as financing for SMEs, suggest interventions are required on a larger scale and for longer than previously estimated. Our research suggests given challenging economics, some of the access-to-capital gaps may never be sufficiently served by traditional capital markets.

Section 3.

Mechanisms for Structuring Catalytic Capital - The How

Part 1

3. Mechanisms for Structuring Catalytic Capital - The How, Part One

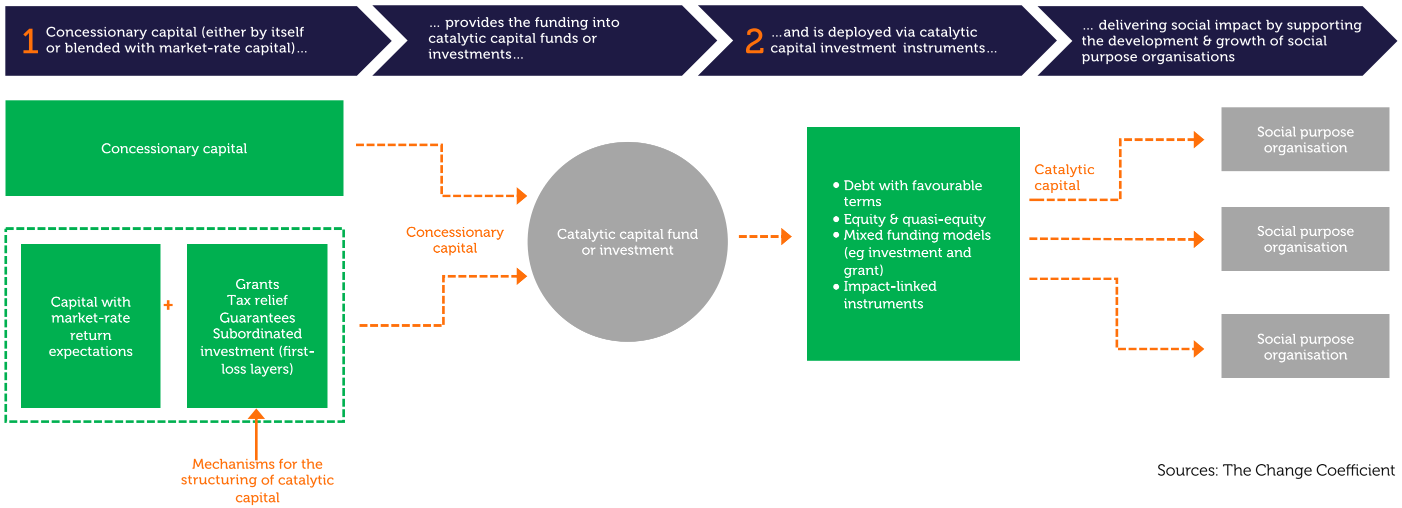
The terms on which an investment is made, reflect the return expected by those providing the investment capital, and the cost of making and managing the investment.

Therefore, to make catalytic capital investments to social purpose organisations and social investment funds, requires access to a pool of capital that is or has been structured to be concessionary and risk tolerant. We refer to the creation of a pool of concessionary risk-tolerant capital as the *mechanisms* for *structuring catalytic capital*. This is the first stage in the creation and deployment of catalytic capital, and the mechanisms used are detailed in this section of the report. These structuring mechanisms are typically used at the fund or wholesale level. The *second stage* is the *design of instruments* that are patient and flexible and through which the capital is deployed, which we detail in section 4. While these instruments can be used at the fund or wholesale level, we have focused on how they are used to invest directly into social purpose organisations.

As depicted in the graphic below, there are four key mechanisms often used for structuring catalytic capital – grants, tax relief, guarantees and subordinated investment (first-loss layer). Please note that this list is not exhaustive as the sector is constantly innovating. We outline each of these structuring mechanisms below.[17]

UK example
Local Access is a place-based joint funding programme, established by Access and Big Society Capital, which aims to support the development of stronger, more resilient and sustainable social economies in disadvantaged places. The programme blends grants with repayable capital.

Figure 7: The structuring and deployment of catalytic capital to social purpose organisations



Sources: The Change Coefficient

3. Mechanisms for Structuring Catalytic Capital - The How, Part One

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3.1 Grants

Grants are the most concessionary and risk-tolerant form of capital. Grants can be pooled with market-rate return capital to absorb investment losses, reduce the cost of the investment for the social purpose organisation and/ or cover the costs of sourcing, making and managing investments. The Growth Fund uses its grant funding in these three complementary ways to help improve access to social investment (see case study 7 on page p86).

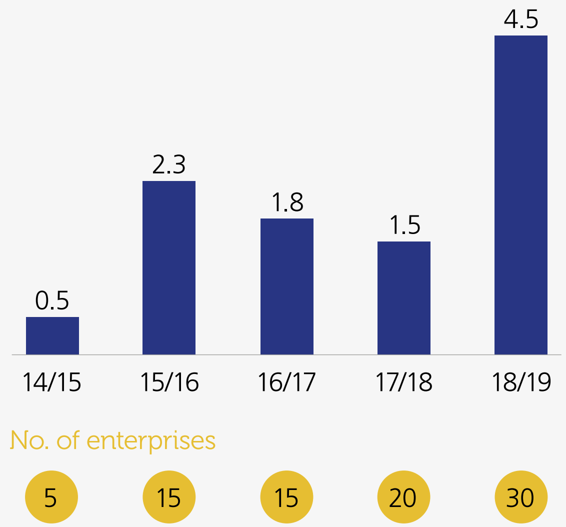
Many of the fund managers and intermediaries interviewed highlighted the weakness in their own balance sheets as significantly inhibiting their ability to provide catalytic capital. The provision of grants into catalytic capital funds has the added benefit of capitalising the fund manager, thereby creating stronger intermediaries over the long term. This is because when the investment into the social purpose organisation is repaid, the portion of the investment funded by grants may remain on the fund manager's balance sheet, thereby capitalising the fund manager. This can then help the fund manager attract further funding, take greater risk, offer investment at lower costs, or offer more flexible patient investment.

3.2 Tax relief

Tax relief on investment works by reducing the cost of the investment for individual investors. Social Investment Tax Relief (SITR), which aimed to create a large pool of catalytic capital for the social sector, enables individuals to reduce their tax bill by 30% of the investment made, provided the investment is held for at least three years. The net cost to the individual investor of a £100k investment therefore falls to £70k. This allows the individual to offer the loan at concessionary rates and bear greater risk. The Bike Project is an excellent exemplar of the power of SITR to support social purpose organisations (see case study 1 on page 72).

In March 2023 it was confirmed in the Spring Budget announcements that the Social investment tax relief (SITR) scheme will end as planned on 5 April 2023.'

Figure 8: Funds raised (£m) through SITR and number of social enterprises that raised funds



Sources: HMRC

3.3 Subordinated investment or first-loss layers

Unlike grant funders, providers of subordinated capital or first-loss layers expect the return of their capital and potentially even a return on capital but are willing to bear a disproportionate share of the risk. In commercial markets such investments typically carry higher rates of return to compensate for the higher risk. In the case of catalytic capital however, the providers of subordinated investment or first-loss layers are typically funding for impact. In some cases, investors providing subordinated investment, or first-loss layers of capital, may have market insights that enable them to better quantify risk in addition to their mission to deliver social impact.

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For example, Ceniarth, a family foundation committed to moving 100% of its endowment to impact investments, has considerable financial inclusion expertise in the US and internationally.

3.4 Guarantees

Guarantees work in a comparable way to subordinated investment or first-loss layers. The key difference is the timing of pay-outs. Guarantees protect investors from potential losses; however, investors are compensated only if the investment is written down or written off. Guarantees can be designed to protect investors against part, or all, of the investment. Government guarantees were widely used throughout the Covid-19 pandemic to absorb risk for investors, ensuring the continued flow of investment into small and medium-sized enterprises (SMEs), charities and social enterprises. On a smaller scale, in recognition of the significant economic contribution of SMEs and the risk aversion of many commercial investors, the UK government has provided guarantees for small loans to SMEs since the financial crisis of 2007, through the Enterprise Finance Guarantee.

Table 2 below compares the catalytic capital structuring mechanisms. None of the mechanisms is cheaper than any of the others in its ability to leverage external capital or cover operating costs and investment losses (with the slight exception of guarantees that benefit from inflation as detailed below).

When structuring catalytic capital, it should be noted that patience is harder to confer to a pool of capital. Grants to cover operating costs can enable repayment holidays at the start of an investment, which is a form of patience, and incentives can be applied to encourage longer-term funding, for example higher levels of guarantees or tax relief on investments held for longer.

UK example

The Enterprise Finance Guarantee supported the provision of £3.3bn of investment to 35,000 SMEs from its launch in 2009 to December 2017. Data from the British Business Bank.

3. Mechanisms for Structuring Catalytic Capital - The How, Part One

Figure 9: Mechanisms for structuring catalytic capital and creating a pool of concessionary risk-tolerant capital.

Mechanism	Creates a pool of concessionary capital	Increases the risk tolerance of capital	Cost to the provider funding the mechanism	When the concessionary funding is provided	Advantage(s)	Disadvantage(s)
Grants	✓	✓	100% of the funding provided.	Funding is drawn down during the life of the fund.	Highly flexible, can be used to fund operating costs, reduce the cost of capital and cover defaults/losses. Depending on the size of the grant and the losses realised, grants can be recycled to fund multiple investments over an extended period.	There is no return of capital. It may be harder to influence the fund manager or the investee once the grant has been deployed.
Tax relief	✓	✓	30% of the funding provided, reflected in reduced income tax revenue.	At the point the investment is made.	Attracts a new pool of investors to the social economy. Once effectively implemented it can create a long-term pool of concessionary risk-tolerant capital, given the disaggregated nature of the investor base (not depending on a single institution/body of institutions). Can be used flexibly to increase risk tolerance and reduce the cost of investment.	Can be complicated to administer in an accessible way – typically need to complete a tax return to benefit, making tax relief more accessible for those on higher incomes or with multiple sources of income. Requires a wider network of investors (individuals) to be educated in the mechanism. Requires additional accreditation/compliance for a fund manager.

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3. Mechanisms for Structuring Catalytic Capital - The How, Part One

Mechanism	Creates a pool of concessionary capital	Increases the risk tolerance of capital	Cost to the provider funding the mechanism	When the concessionary funding is provide	Advantage(s)	Disadvantage(s)
Subordinated investment and first-loss layers		✓	Up to 100% of the subordinated investment/ first-loss layer contingent on performance of the fund/ investment.	Funding is drawn down during the life of the fund.	Potential for return of capital and even some return on capital, depending on the performance of investments.	Capital is tied up for the life of the fund or investment.
Guarantees		✓	Up to the amount of the guarantee, contingent on the performance of investment.	After the investment is written down/off.	Potential for return of capital and even some return on capital, depending on the performance of investments. Only pay out in the event of default, therefore benefiting from the decline in the real value of the original loan.	If the guarantees are too high as a proportion of the total investment, it can lead fund managers to make poor investment decisions (this is more relevant for institutions such banks, which do not have to raise their investment capital). Fund managers who regularly raise funds need a sound investment track record.

Source: The Change Coefficient.

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Section 4.

Instruments for the Deployment of Catalytic Capital The How

Part 2

4. Instruments for the Deployment of Catalytic Capital The How Part Two

Contents

Catalytic capital is patient, concessionary, flexible and risk-tolerant (or some combination thereof); as a result, many of the calls for more catalytic capital focus on equity and quasi-equity.

This is because equity and quasi-equity are inherently patient and risk-tolerant investment instruments. However, any investment instrument can be used to deploy catalytic capital, and a range of instruments is needed to effectively serve the varying needs of social purpose organisations.

We have grouped the investment instruments used to deploy catalytic capital into four categories – debt, equity and quasi-equity, mixed funding models where grants are deployed alongside repayable investment, and impact-linked instruments.

The graphic below shows the range of instruments that falls into each of these categories, mapped by the complexity of the instrument and the level of risk-sharing between the investor and investee.

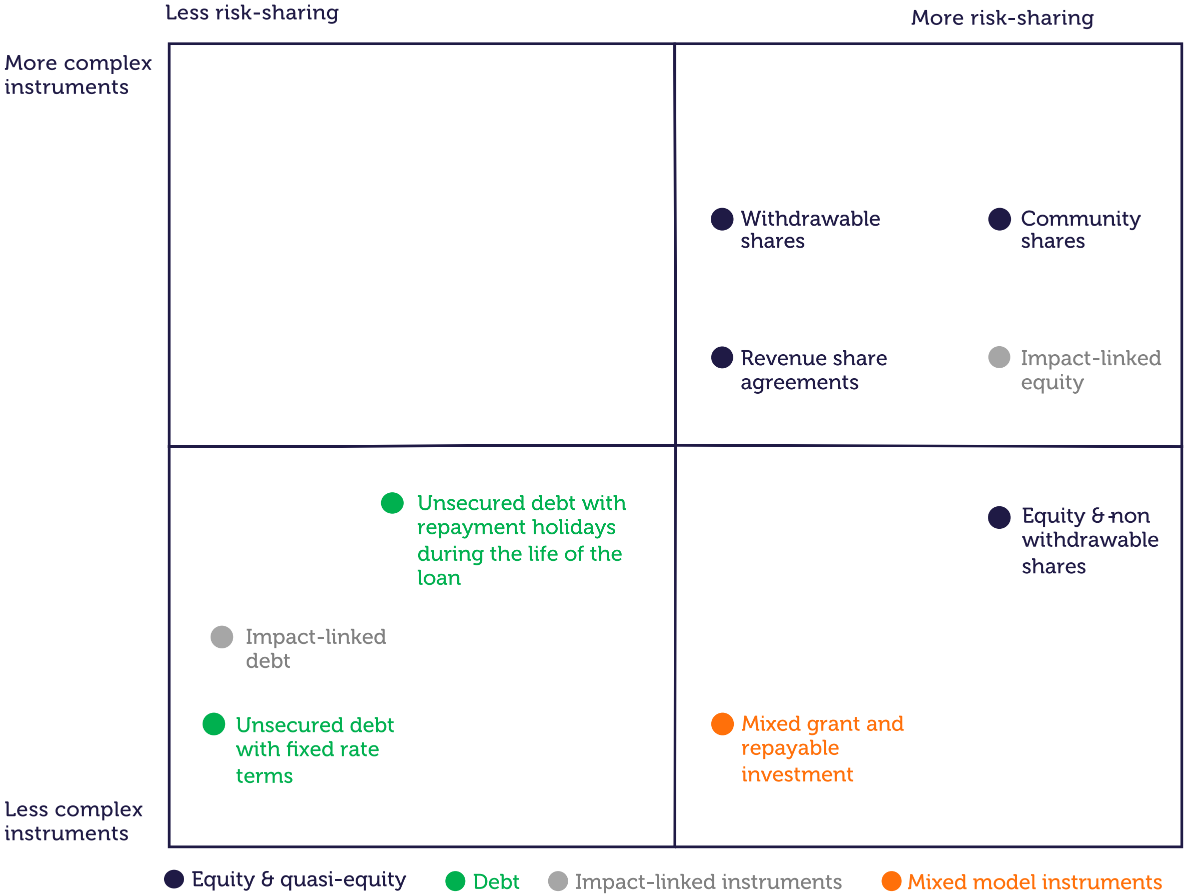

Figure 10: Risk-sharing (between investee and investor) vs complexity of catalytic capital instruments.

Source: The Change Coefficient.

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Risk-sharing is often conflated with risk tolerance; however, this is not the case with catalytic capital. A catalytic capital debt fund investing in early-stage social purpose organisations with high social impact potential, may assume a write-off rate of 60% across the portfolio. Although the investing instrument is debt, the fund is potentially more risk-tolerant than a later-stage, quasi-equity fund supporting well-established social purpose organisations to strengthen their balance sheet and bid for larger public service delivery contracts.

We elaborate on the four types of catalytic capital instrument below.

4.1 Debt

Catalytic capital deployed as debt is typically unsecured or has a low security-to-loan value, has lower-than-market risk-adjusted interest rates, has an interest and capital repayment holiday, and has some form of flexibility. Portfolio management is a key driver of flexibility, with catalytic capital debt funders often renegotiating terms during the life of the investment.

Most catalytic capital debt funds researched offer interest and capital repayment holidays in the first year or more of the investment. This allows social purpose organisations to focus on operations without having to worry about repayments. Historically a year's payment holiday has been standard, however newer funds tend to offer longer repayment holidays (18-36 months), reflecting evidence of greater patience requirements. Once the repayment holiday is over, most catalytic capital debt funds apply simple amortisation to the debt, i.e. interest and capital are repaid in equal annual instalments for the life of the loan (although payments are typically made monthly or quarterly). Few funds offer repayment holidays as standard during the life of the loan, however all catalytic capital funds/investors are responsive to investee circumstances, and significant portions of catalytic capital portfolios have been restructured. Futurebuilders is an excellent example of this kind of flexibility, with 46% of all investments having their payment terms renegotiated since the 2008/09 economic crisis (see case study 4 on page 78).

UK example

Within its 'impact-first' social investment programme, the Joseph Rowntree Foundation has provided catalytic capital to London Rebuilding Society to help older, low-income homeowners refurbish their homes. JRF's investment is split equally between a seven-year loan and transferable shares. Both instruments have a three-year grace period when neither dividends nor interest accrue. Both instruments are patient and have been designed flexibly.

4.2 Equity and quasi-equity

Equity is a challenging investment instrument for social purpose organisations. Many social purpose legal structures prohibit the sale of equity and realising an exit[18] from equity investments in social purpose organisations can be challenging.

Quasi-equity, which mirrors some of the risk-sharing qualities of equity, offers an alternative that many interviewees acknowledged as fit for purpose for the social economy.

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There are three kinds of quasi-equity:

- **Non-withdrawable shares**: Investment made as non-withdrawable shares remains within the investee entity into perpetuity and pays a targeted annual dividend only in the event there is sufficient profitability. This is highly concessionary funding and is offered by only a limited number of funders, that typically have very clear impact objectives (such as Fair4All Finance's investment in affordable credit provider Moneyline).
- **Withdrawable shares**, as used in community share offers, allow the investor to request repayment, but only after a certain period has passed and with repayment contingent on the investee's ability to repay.
- **Revenue share agreements** as used by Firstport, Sumerian, the Esmée Fairbairn Foundation, and The Young Foundation's education impact fund, are repaid through a percentage of revenues up to a pre-agreed total repayment cap (case studies on the first three are provided on pages 80, 82 and 87) The revenue share level is agreed between the investee and investor upfront, and is typically calculated and paid on revenues reported in monthly or quarterly management accounts. As with catalytic debt instruments, most of the revenue participation agreements include a repayment holiday of a year or more. The Young Academy Investment Fund, which launched in 2014, included at least a two-year payment holiday. This gave investees a longer window to experiment before they needed to make repayments and proved successful at driving growth and reducing the financial risk of the investment.

Our research did not identify any profit share agreements. We believe this reflects a critical distinction between traditional for-profit enterprises, which exist to maximise profits, and social purpose organisations, which exist to maximise impact and will forgo profit to do so. Traditional commercial investment approaches, which focus on profitability and balance sheet strength, therefore often underestimate the financial viability of social purpose organisations, highlighting the need for a different approach not just to the provision of capital, but to the way investments are assessed.

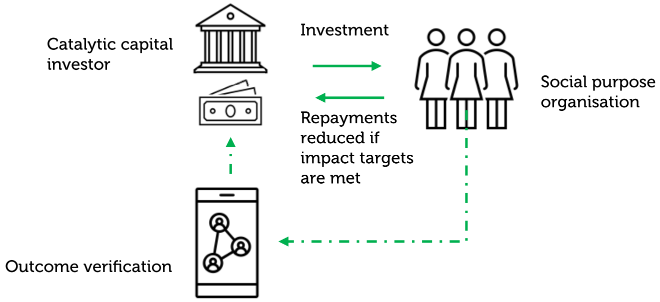
4.3 Mixed funding models

Mixed funding models are instruments that include a portion of repayable finance (typically debt – which itself may be patient, risk-tolerant, carry lower-than-market interest rates and be flexible) alongside a grant. Some funders vary the ratio of grant to repayable finance to reflect affordability or impact potential, however this can increase complexity and make marketing the fund more challenging. The Postcode Innovation Trust's Social Investment Programme in Scotland offers a standard blend of grant and repayable debt (50:50) to the social enterprises it funds.

4.4 Impact-linked instruments

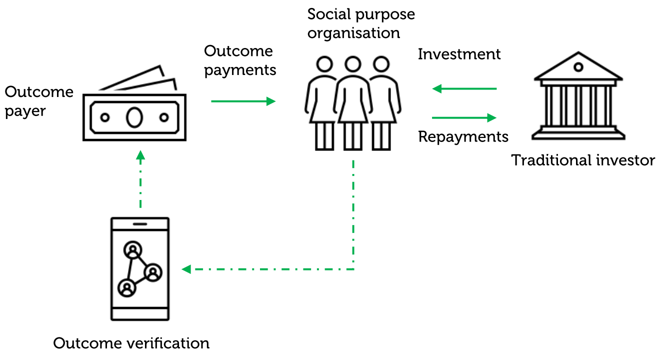
All catalytic capital delivers social impact, however impact-linked instruments explicitly quantify the trade-off between financial returns and impact. Impact linked debt, for example, may carry reduced interest rates if certain impact targets (also referred to as outcome triggers) are met, such as the proportion of customers from lower-income groups. These impact-related payments or concessions can either be built into an investment, as in Figure 11 below, or can be made as separate success payments as depicted in Figure 12. In both cases the reductions in payments or outcome payments relate directly to the investment and will therefore be capped to the size of the investment. These payments are not to be confused with the outcome payments made in social impact bonds, which are revenue payments.

Figure 11: Integrated impact-linked financing .



Source: Roots of Impact, The Change Coefficient.

Figure 12: Success payments structured outside the investment instrument.



Source: Roots of Impact, The Change Coefficient.

These models of catalytic capital are being championed by Roots of Impact through its Impact-Linked Finance Fund[19] (see case study 15 on page 108). More locally, Kindred CIC, with support from Power to Change, is making 0% interest rate loans to socially trading organisations in the Liverpool City Region, with part of the monthly capital repayment potentially payable by evidencing the delivery of social value.

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'Despite provision of pockets of catalytic capital in the UK there are growing calls to increase the availability of patient, concessionary, risk tolerant and flexible capital for social purpose organisations. Given the reach of catalytic capital funds and investors researched, we believe this implies a significant shortfall in the provision of catalytic capital and not that existing catalytic capital funds are failing to reach the right organisations. This shortfall likely reflects both insufficient volumes of catalytic capital but also gaps in the type of catalytic capital provided e.g. across the returns spectrum or capital that is sufficiently patient.

In this section of the report, we seek to quantify the annual shortfall in the provision of catalytic capital to social purpose organisations. We have not sought to size the provision and shortfall of wholesale catalytic capital given a lack of visibility on this market. We recognise this analysis is severely limited by gaps in data and the fact that an increase in supply will surface additional demand. That said, an indicative market size will help stimulate conversations and collaboration.

Our calculations suggest social purpose organisations need £287m to £578m of catalytic capital per year. This is based on our estimate of current catalytic capital provision of £98m and a potential market gap of £189m to £480m. While these numbers are highly indicative, the scale of potential demand highlights the need for greater provision of catalytic capital.'

5.1 Key assumptions

To estimate the gap for catalytic capital we have taken a top-down approach using data on the number of social purpose organisations and the amount of funding sought. We then apply assumptions on the proportion of finance that needs to be catalytic capital based on research on the financing needs of social purpose organisations. Key assumptions used include:

1. **Number of social purpose organisations**

There are an estimated 215,000 to 232,000 social purpose organisations in the UK. This includes the 100,000 social enterprises[20] estimated by Rebecca Harding in the Social Enterprise UK ("SE UK") report "*Hidden Revolution: Social Enterprise in 2018*" who have a social or environmental mission and direct more than half of their profits to that mission. This is slightly lower than data from the Department for Business, Energy & Industrial Strategy and the Department for Digital, Culture, Media & Sport who estimated there were 131,000 social enterprises in 2019 (with more than half of their profits directed towards their mission) in the UK[21]. We have used the SEUK figure to reflect the potential impact of the pandemic, however there could be upside risk to our figures.

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In addition to the asset locked social enterprises we add 115,000 to 132,000 enterprises[22] who are social or environmental impact mission-led businesses permitted to distribute all profits as estimated by Deloitte in its 2016 report *"In pursuit of impact: mission-led businesses".*

2. Amount of repayable finance per enterprise

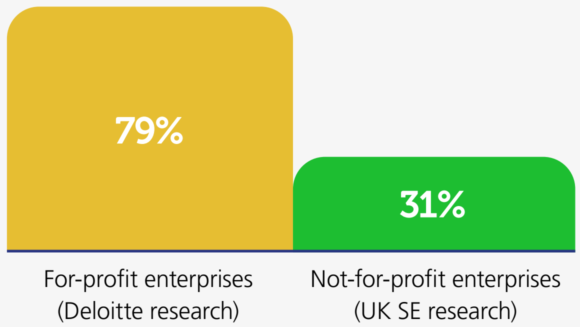
Multiple sources have been considered to estimate the amount of repayable finance social purpose organisations typically seek, whether that finance is catalytic capital or not (which is shown in Figure 14). We have included estimates over an extended period as COVID-19 has distorted market trends.

Most of the sources refer to the amount of finance sought by not-for-profit entities. Over half our enterprises comprise for-profits which are smaller on average. Using data around the proportion of social purpose organisations in different revenue bands for not-for-profits and for-profits, we estimate that the average revenues of for-profit organisations are c50-60% of their not-for-profit counterparts. Accordingly, we assume that for-profits require 50-60% of the funding required by not-for-profits. This reduces our median estimate of £63,750 of repayable finance per social purpose organisations to £48,000 across them all. We recognise this does not reflect the fact that for-profits may have higher margins and therefore be able to take on more investment, however, given a lack of data we have chosen a more conservative assumption. Median and not mean estimates have been used for our calculation on the assumption that larger investments which brought up the mean are less likely to require catalytic capital. We acknowledge this may be a conservative assumption.

3. Proportion of social purpose organisations needing catalytic capital

We use Shift Design's 2020 research (Beyond Demand: The social sector's need for patient, risk-bearing capital) to help quantify the need for catalytic capital. The research, which included a survey of 321 social purpose organisations across England and Wales, found that 18% of social enterprises needed patient, risk-tolerant capital. Shift acknowledged that its sample survey likely under-represented companies limited by shares.

Figure 13: % of social purpose organisations with revenues <£50k pa



Sources: Deloitte 2016 report "In pursuit of impact", SE UK 2017 report "Hidden Revolution", The Change Coefficient Analysis

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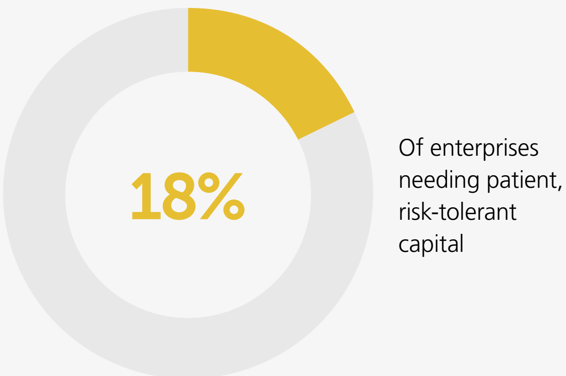
Figure 14: Estimates of repayable finance per social purpose organisation

Parameter	Median	Average
Repayable financing sought – BSC 2020	£75,500	£584,554
Investment size per Growth Fund	£67,000	
Average social investment size – Cabinet Office, 2011/12		£246,000
Repayable finance sought – SEUK 2021 (2020 data)	£50,000	
Repayable finance sought – SEUK 2019	£50,000	
Repayable finance sought – SEUK 2017	£80,000	
Repayable finance sought – SEUK 2015	£60,000	
Average	£63,750	
Average adjusted for smaller funding scale of for-profits	£48,000	

Sources: BSC market data, SEUK data from its biannual State of Social Enterprise reports, Growth Fund, Cabinet Office, The Change Coefficient estimates and analysis

Figure 15: % of social purpose organisations needing patient, risk-tolerant capital in survey of 321 social purpose organisations.



Sources: Shift Design

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5.2 Catalytic capital gap in the UK – calculation methodology

To estimate the gap for catalytic capital, which is the demand for catalytic capital currently not served by the market, we explore three distinct potential sources of demand:

1. **Catalytic capital needed where no funding was applied for:** For those social purpose organisations that chose not to apply for funding but would have if catalytic capital was available.
2. **Insufficient finance received:** For those social purpose organisations that received repayable finance, the gap between the amount of funding applied for and the amount of funding they required where catalytic capital is likely to have been the appropriate mechanism to close that funding gap.
3. **Catalytic capital instead of non-repayable grants:** For those social purpose organisations that received grant funding, a small proportion could have absorbed catalytic capital instead of non-repayable grants.

Catalytic capital should not crowd out other forms of investment. Therefore, we do not consider cases where social purpose organisations received repayable finance that was sub-optimal (too expensive, too short term, inflexible) and potentially hampered the organisation's ability to grow. That said, there is a clear impact case for providing such social purpose organisations with catalytic capital.

Gap #1 – catalytic capital required for a proportion of social purpose organisations that did not seek repayable finance

The aim of catalytic capital is to fill access-to-capital gaps; accordingly, we assume that some portion of social purpose organisations that did not apply for repayable finance, would do so if they could access catalytic capital:

- We estimate 10-25% of social purpose organisations should have applied for funding of some sort. This is based on SEUK's State of Social Enterprise research. An average of 35% of social enterprises surveyed annually from 2017 to 2021 applied for funding in any given year. This means 65% did not. In 2019, of the estimated 65% of social enterprises that did not seek funding, as many as 62% stated they did not need funding, implying up to 38% may have needed funding but did not apply for it. In the 2021 survey, the most common reasons given for not applying were that they believed their application would be rejected (15%), time pressures (15%) and the timing (14%). We therefore estimate 15% of the 65% of enterprises would have benefited from catalytic capital.
- Only those social purpose organisations with a sound financial[23] and impact investment case should receive catalytic capital. SEUK's surveys in 2019 and 2021 found 11% and 16% of social enterprises applying for funding were rejected, an average of 13%. The rejection rate is likely to be higher for those that chose not to apply for funding, and we therefore assume 40% fail in their bid for funding.

Figure 16: Catalytic capital gap #1 – amount of catalytic capital per year for social purpose organisations (SPOs) that sought no funding

Item	Low end	High end	Workings
% of SPOs not applying for funding	65%	65%	[a]
% of those SPOs that should have applied for funding	15%	38%	[b]
% of SPOs that should have applied for funding	10%	25%	[c] = [a] x [b]
% of SPOs needing patient, risk-tolerant capital	18%	18%	[d]
% of SPOs whose funding application is approved	60%	60%	[e]
% extra SPOs that should receive catalytic capital	1%	3%	[f] = [c] x [d] x [e]
Total no of SPOs	215,000	232,000	[g]
Extra no of SPOs that could receive catalytic capital	2,252	6,157	[h] = [f] x [g]
Repayable financing sought per SPO	£48,000	£48,000	[i]
Funding gap	**£108m**	**£296m**	**[j] = [h] x [i]**

Sources: BSC market data; SEUK data from its biannual State of Social Enterprise reports and Hidden Revolution: Social Enterprise in 2018; Deloitte 2016 report, The Impact: Mission-led Businesses; Shift Design, Beyond Demand 2020 report; Growth Fund; Cabinet Office; The Change Coefficient estimates and analysis.

Based on these assumptions, our analysis in Figure 16 above suggests c£108m to c£296m of additional catalytic capital per year is needed for those social purpose organisations that do not currently seek funding.

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Gap #2 – insufficient funding secured by social purpose organisations that sought repayable finance

Our analysis suggests £7m to £36m of catalytic capital is needed per year to address the funding shortfall for social purpose organisations securing insufficient investment. The table below sets out our workings. Most of the assumptions in Figure 17 have been discussed and set out in section 5.1:

- For the assumed potential funding gap percentage (labelled [m]), data from SEUK has been used that found that social enterprises suffered an average c£1k funding shortfall when they sought investment. This equates to c2% of the amount of total investment sought based on our estimates. At the higher end we assume a 10% shortfall to reflect buffers typically included in commercial investment projects (5-20%).
- According to SEUK's 2019 and 2021 surveys of social enterprises, 16% and 20% of social enterprises sought repayable finance in those years respectively, an average of 18% (labelled [k] in the next table).

Figure 17: Catalytic capital gap #2 – insufficient funding per year provided to social purpose organisations (SPOs) that sought repayable finance

Item (workings)	Low end	High end
Total no of SPOs [g]	215,000	232,000
% of SPOs that seek repayable finance in any year [k]	18%	18%
No of SPOs seeking repayable finance [l] = [g] x [k]	38,700	41,760
Repayable finance sought [i]	£48,000	£48,000
% funding gap [m]	2%	10%
Repayable finance gap per SPOs [n] = [j] x [m]	£1,073	£4,800
% of SPOs needing patient, risk-tolerant capital [d]	18%	18%
Catalytic capital funding gap per SPO [o] = [n] x [d]	£193	£864
Catalytic capital gap #1 [p] = [l] x [o]	**£7m**	**£36m**

Sources: BSC market data; SEUK data from its biannual State of Social Enterprise reports and Hidden Revolution: Social Enterprise in 2018; Deloitte 2016 report, The Impact: Mission-led Businesses; Shift Design, Beyond Demand 2020 report; Growth Fund; Cabinet Office; The Change Coefficient estimates and analysis.

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Gap #3 – substituting a small proportion of grants for catalytic capital

The final catalytic capital gap we have considered is the small proportion of grant funding that could have been provided as catalytic capital. With this analysis we are not advocating for grants to be replaced wholesale by repayable finance, but merely reflecting evidence from the research and interviews, which highlighted that in the absence of access to catalytic capital, many social purpose organisations were applying for grants, with varying degrees of success. We have assumed just 2-4% of UK annual grant funding could be substituted by catalytic capital for two reasons:

1. For-profit enterprises represent c55% of the volume of enterprises in our calculations, and for-profits typically receive significantly less grant funding than their asset-locked counterparts.
2. A small proportion of grants provided are repayable and are therefore already likely to be catalytic capital.

Figure 18: Catalytic capital gap #3 – catalytic capital substituted for a small proportion of grants per year

Item	Low end	High end	Workings
Estimated total grant spending by UK-based foundations	£6,500m	£6,500m	[q]
Of which 100% spent in the UK (National Lottery & hospital-linked charities)	£900m	£900m	[r]
Total spent by UK-based foundations in the UK and internationally	£5,600m	£5,600m	[s] = [q] - [r]
% spent in the UK	50%	50%	[t]
Total spent in the UK	£2,800m	£2,800m	[u] = [s] * [t]
Add back UK-only funding	£3,700m	£3,700m	[v] = [u] + [r]
Assumed % of grants substituted for repayable finance	2%	4%	[x]
Catalytic capital gap #2	**£74m**	**£148m**	**[y] = [v] x [x]**

Sources: Foundation Giving Trends 2017, an Association of Charitable Foundations report authored by Dr Cat Walker, Dr Cathy Pharoah and Keiran Goddard; The Change Coefficient analysis and estimates.

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Figure 19: Total catalytic capital gap per year in the UK

Item	Low end	High end	Workings
Gap #1 – more SPOs to receive catalytic capital	£108m	£296m	[j]
Gap #2 – more catalytic capital to those that sought finance	£7m	£36m	[p]
Gap #3 -– catalytic capital to replace a small % of grants	£74m	£148m	[y]
Total potential catalytic capital funding gap	**£189m**	**£480m**	**[z] = [j] + [p] + [y]**

Sources: The Change Coefficient analysis and estimates.

To estimate the value of annual UK grant funding, we have drawn upon the Association of Charitable Foundations' Giving Trends analysis. We combined the estimated total grant spending by UK-based foundations (£6.5bn in 2017, pre-Covid-19) and adjusted this for the amount spent in the UK (50%). We also adjusted for large funders such as the National Lottery, which funds only within the UK. Assuming 2-4% of grants are deployed as catalytic capital, this would represent a c£74m to c£148m catalytic capital requirement each year, as shown in the table above.

Overall catalytic capital gap per year in the UK

Putting these three catalytic capital gaps together implies additional demand for a total c£189m to £480m of catalytic capital each year.

5.3 Existing size of catalytic capital in the UK

To estimate the current provision of catalytic capital, we have compiled a summary of catalytic capital providers and compared this with a top-down analysis of market provision. Figure 20 shows current market provision and implies a market size of just under £60m of catalytic capital deployed on average annually. We recognise this list is not exhaustive and fails to capture concessionary investments for which there is limited visibility, such as those made by local authorities on an ad hoc basis.

Given the gaps in our dataset, for comparison we look at the proportion of social enterprises seeking and obtaining catalytic capital. SEUK's latest survey found that of those social enterprises applying for finance, 9% applied for blended capital, 8% applied for equity, 5% applied for quasi-equity/equity-like investment, and 39% applied for loans (we assume that up to a third of these loans are catalytic capital). We therefore assume a range of 5-15% of social purpose organisations seeking catalytic capital given for-profits may have access to equity. Of those enterprises seeking catalytic capital, we assume 70% are successful, again acknowledging that some social purpose organisations will be rejected, as they have other funding options or do not have strong investment and impact cases (as shown in Figure 21).

This implies an existing market size of £65m to £210m. Taking an average of these figures and the current market provision shown in Figure 20 implies current provision of £98m.

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Figure 20: Selected UK programmes and organisations currently or recently deploying catalytic capital in the UK

Programme/organisation	Est total deployed	Years over which deployed to entities	Est average deployed pa
Community shares – total market	£155m	2012	£14m
Ethex (platform for retail investor crowdfunding)	£105m	2013	£11m
Foundations	n/a	each year	£10m
Fair4All Finance	**£22m**	2020	**£9m**
Growth Fund	£45m	2015	£8m
Individual investors utilising SITR	£17m	2014	£2m
Arts Impact Fund, and Arts & Culture Impact Fund	£14m	2015	£2m
Sumerian, Firstport and other boutique funders	n/a	each year	£2m
Total			**£58m**

The Change Coefficient analysis and estimates using a mix of both desktop research and interviews with some organisations.

Figure 21: Estimated amount of catalytic capital currently deployed

Item	Low end	High end	Workings
Total no of social purpose organisations	215,000	232,000	[g]
% seeking repayable finance in any one year	18%	18%	[k]
Of which, % seeking catalytic capital	5%	15%	[w]
And of which, % receiving catalytic capital	70%	70%	[x]
Est no of SPOs currently receiving catalytic capital	1,355	4,385	[y] = [g] x [k] x [w] x [x]
Repayable finance sought	£48,000	£48,000	[i]
Current catalytic capital funding to SPOs	**£65m**	**£210m**	**[z] = [y] x [i]**

The Change Coefficient analysis utilising The Change Coefficient estimates; BSC market data; SEUK data from its biannual State of Social Enterprise reports and Hidden Revolution: Social Enterprise in 2018; Deloitte 2016 report, The Impact: Mission-led Businesses; Shift Design, Beyond Demand 2020 report; Growth Fund data.

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5.4 Potential market size for catalytic capital in the UK

Putting together our estimate of the current market size of catalytic capital (section 5.3) of £98m with the potential market gap that has been estimated (section 5.2) of £189m to £480m, suggests a potential market size of c£287m to c£578m of catalytic capital per year in the UK.

As we noted, estimating the gap in catalytic capital provision and the current provision of catalytic capital is highly challenging, and outputs need to be used cautiously. However, the scale of the potential market suggests more work needs to be done to support those social purpose organisations currently failing to access suitable capital.

Section 6.

Barriers to the Deployment of More Catalytic Capital – The Why Not

6.1 No common understanding of catalytic capital and its role in the wider investment market

6.2 Lack of concessionary capital

6.3 Lack of data and evidence

6.4 Lack of co-ordination

6.5 Market capacity to deploy catalytic capital

6.6 Language of subsidy

6.7 Stakeholder specific barriers to greater engagement with catalytic capital

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Across the UK there are pockets of high-impact catalytic capital deployment.

Stakeholders – including foundations, fund managers, and market-makers such as Access – The Foundation for Social Investment – are innovating with the way they structure and deploy capital, and in doing so are addressing critical access-to-capital gaps for social purpose organisations. However, raising and deploying catalytic capital is often driven by a particular impact focus or investment need and occurs in silos, with limited activity aimed at building a market for catalytic capital. Interviews with stakeholders including the providers of concessionary capital, fund managers, asset owners seeking market-rate returns, social purpose organisations and intermediaries, highlighted various barriers to increased deployment of catalytic capital.

6.1 No common understanding of catalytic capital and its role in the wider investment market

Catalytic capital is a complex concept that covers a range of structuring mechanisms, investment instruments and objectives. As a result, the dialogue around catalytic capital is confused, and the outcomes of catalytic capital funds and investments are sometimes poorly understood and reported. In the absence of a clear narrative, the focus naturally falls on outcomes that are easier to measure and qualify, such as the role of catalytic capital in leveraging new sources of capital into social purpose organisations. Insufficient attention is paid to the more complex outcomes, including the remaining access-to-capital gaps, how the investment catalyses the investee in terms of growth and development, and the ultimate impact on those served by the social purpose organisation.

This complexity also makes it hard for the providers of concessionary capital to understand and assess exactly what they are funding – are they funding impact or investment? Should it be funded from their capital or from their revenue funds?

6.2 Lack of concessionary capital

The greatest barrier to increased deployment of catalytic capital is the lack of concessionary, risk-tolerant and patient capital. There is increasing activity at the return-on-capital end of the spectrum, with many high-profile foundations and family offices committing portions of their endowment to impact investments targeting positive financial returns that are typically below market-rate returns. The Esmée Fairbairn Foundation, the Joseph Rowntree Foundation and Ceniarth are among the foundations that have, for many years now, pioneered this approach.

At the more concessionary end of the spectrum, where there is an expectation of capital loss, the most active funders are unsurprisingly those with a mandate to spend down their assets. This includes Access, which has a mandate to improve access to capital for social enterprises, and Power to Change, which has funded a range of innovative catalytic capital funds including the Booster Fund (case study 2 on page 74) and Kindred CIC.[24] In response to the Covid-19 pandemic, the government also stepped in to support the flow of catalytic capital to social enterprises through various guarantee schemes,[25] however it is unclear how long this support will be available.

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Our interviews highlighted the following reasons for the lack of concessionary risk-tolerant capital available for deployment as catalytic capital:

- There is **significant competition for concessionary capital** with most organisations managing their funds as two separate pools of capital – grants that are disbursed purely for impact with no expectation of repayment, and social or impact investment where a return is expected and market principles such as concerns over the provision of subsidies dominate. This leaves the field between these poles, that is the domain of catalytic capital, relatively underdeveloped.

- **Providers of concessionary capital, particularly foundations, tend to fund impact areas.** Impact areas range from the very broad, such as poverty alleviation, to the very narrowly defined, such as particular health outcomes. Impact areas are determined by strategic priorities and do not necessarily align with market opportunities around catalytic capital. These strategic focus areas, which can change on medium-term cycles (three to five years), make it harder for organisations such as foundations to support generalist funds that improve access to capital for social purpose organisations.

- Conversations around catalytic capital tend to focus on the mechanisms through which pools of capital are made concessionary and risk-tolerant, and the instruments through which catalytic capital is deployed. This **does not align with the social impact focus of funders, including foundations, individuals and corporate foundations.**

- The UK social investment market has relatively well-developed infrastructure, with Access working alongside Big Society Capital to ensure access to capital for social enterprises. With the opportunity for more funding to be allocated to the sector through the Dormant Assets Act, many stakeholders feel that supporting the **increased deployment of catalytic capital, particularly at the capital loss end of the spectrum, is the domain of central government.**

- **Trust deficits and concerns about funding private gain.** When highly concessionary capital is structured alongside market rate return capital, through grants, guarantees or subordinated funding, there is a risk this funding could subsidise the returns of private investors. This is a significant concern for many funders, as their mandates prohibit their funding from being used for private gain. Conversely, maintaining strict limits on boosting private returns reduces the attractiveness of catalytic capital to commercial investors, and can make it harder to raise sufficient capital, particularly at the wholesale level. With interest rates rising, competition for capital is likely to increase, making it even more challenging to attract commercial investors to the social economy.

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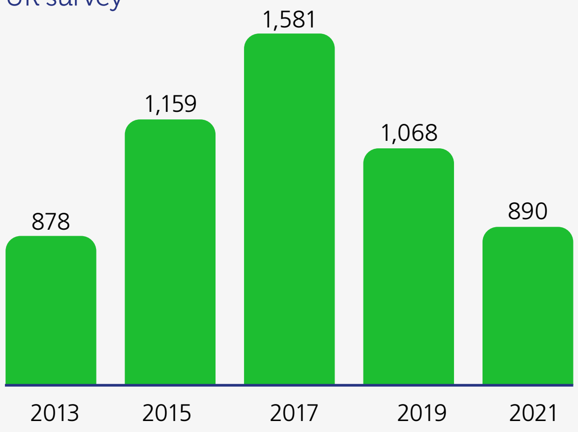
6.3 Lack of data and evidence

The contribution of small and medium-sized enterprises to economic prosperity is well understood, with national data collected regularly through the Office for National Statistics (ONS). Comparatively the contribution of the social economy is far less well understood in terms of both economic and social value. Work by organisations such as SEUK through its State of Social Enterprise surveys, data from the Growth Fund and data from Social Investment Business' Futurebuilders fund, are highly valuable, but do not cover the entirety of the social economy and lack the reach of institutions such as ONS. More data collection on the social and economic impact of social purpose organisations, and data sharing between those deploying catalytic capital, are needed to build a strong case for the provision of catalytic capital, particularly if government is to engage in a
more sustained way with this agenda.

The lack of data reflects sector-wide challenges around data collection in the social investment sector, and a need to balance the cost and challenges of collecting comparable data across diverse social purpose organisations, without oversimplifying data and in doing so limiting its analytical value. The ability to analyse data across catalytic capital funds is critical to ensuring the efficient allocation of concessionary capital.

Figure 22: Number of survey respondents to SEUK's biannual State of Social Enterprise UK survey



Source: SEUK State of Social Enterprise reports.

6.4 Lack of co-ordination

While there are pockets of catalytic capital deployment across the UK, there is very little co-ordination between the providers of concessionary capital, the providers of market-rate return capital seeking to support the catalytic capital market, and fund managers seeking to deploy catalytic capital. Existing platforms tend to support individual groups of stakeholders such as foundations, fund managers or high-net-worth individuals (HNWIs). However, given the complexity of effectively and efficiently deploying catalytic capital, much greater co-ordination and co-operation across stakeholders are needed to grow the market. For example, philanthropic funders who design catalytic capital funds hoping to attract commercial funding in the longer term, but do not engage with commercial investors until the late stages of the fund, miss significant opportunities. Working with commercial investors at the earliest stages, ensures the right data is collected to give those commercial investors the confidence they need to invest in follow-on funds. Equally where long-term concessionary funding is needed, engaging with a wider pool of concessionary capital funders at the earliest stages ensures they are brought in and the evidence they need to invest is collected.

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6.5 Market capacity to deploy catalytic capital

Effective deployment of catalytic capital requires a balanced approach to financial risk and impact. It requires investment managers and investment committees who can assess ideas and teams without requiring a high burden of proof, and balance potential financial trade-offs against transformative social impact. Many of the fund managers we spoke to are highly conscious of these organisational challenges and what we term 'risk creep', when structures are highly formalised and those involved in the investment decisions such as investment committees become distanced from the impact mandate.

6.6 Language of subsidy

Much of the discourse around catalytic capital uses the language of subsidy. This is unhelpful and leads stakeholders to focus on the financial returns of catalytic capital, and not the social returns.

Even within this report, we talk about investments where there is some loss of capital, instead of talking about impact funding with significant return of capital. While this may seem like an unnecessary distinction, a focus on the level of subsidy shifts focus from the social value created. This can lead to the continued undervaluation of social impact, and therefore underinvestment in social impact. The focus on subsidy is not helped by the fact that objectively quantifying social value is not easy, and even undesirable in some cases.

6.7 Stakeholder specific barriers to greater engagement with catalytic capital

In addition to the market-wide barriers to the increased deployment of catalytic capital set out in sections 6.1-6.6, many stakeholders faced specific challenges as detailed below.

Foundations – many foundations are exploring how to better align their endowments with their charitable purposes; however shifting decades of established practice is challenging, especially when the financial markets are now ostensibly offering far more socially aligned funds (ESG funds delivering market returns). Issues include:

1. Uncertainty as to how endowments can be deployed or invested – despite guidance from the Charity Commission for England & Wales on programme-related and mixed-motive investment, and from the Office of the Scottish Charity Regulator on social and environmental returns, confusion remains regarding to what extent foundations are permitted to provide catalytic capital.

2. Endowments are typically managed by fund managers who are divorced from the day-to-day work of the foundation and see their role as maximising income for the foundation.

3. Many are reluctant to act without greater evidence from peers who have been early adopters of a more socially aligned and concessionary investment approach.

6. Barriers to the Deployment of More Catalytic Capital – The Why Not

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4. Many foundations lack the capacity to manage catalytic capital funds internally, and struggle to find qualified intermediaries to support them in their asset allocation decisions.

Highly progressive **family offices** looking to support social purpose organisations through the provision of catalytic capital, struggled to find advisers who knew the market and could help them develop high-impact investing strategies. Sourcing deals has also been challenging, with fewer angel networks in the UK than in other comparable markets.

High-net-worth individuals are often unaware of opportunities to fund social purpose organisations through catalytic capital, and do not know about schemes such as SITR. The Individual Impact Investing Commission recently came to similar conclusions with reference to impact investing.[26] Greater education and potential simplification of SITR and the system for tax rebates on catalytic capital could help unlock more funding from a wider range of individuals. Many HNWIs also lack opportunities to connect with social entrepreneurs. As catalytic capital is as much about investing in people as it is about impact and investment, this lack of connection makes it harder for HNWIs to take more concessionary risk-tolerant positions.

Commercial investors can engage with catalytic capital by:

1. Providing funding to be blended with concessionary capital to fund catalytic capital funds, that is funds that make catalytic capital investments into social purpose organisations.
2. Investing in impact funds alongside catalytic capital investors who are seeking to establish and grow impact/social investment fund managers.
3. Providing patient or flexible capital that may not be risk-tolerant or concessionary.

In each case the engagement of commercial investors increases the pool of capital available and can help reduce the amount of concessionary or catalytic capital required by funds in the long term. Both in the UK and globally, considerable efforts have been made to engage more commercial investors with impact funds, social investment and catalytic capital. However, commercial investment flows into the sector remain lower than hoped. This is the result of a variety of factors, including insufficient track records of funds, a lack of liquidity and insufficient scale, as well as significant competition for investment, particularly given the explosion in ESG funds,[27] which offer a form of positive impact, but typically carry higher returns and a lower risk profile than social investment or catalytic capital. Commercial investors such as pension funds and wealth managers also have a fiduciary duty to maximise returns, which limits the kind of catalytic capital they can provide.

Section 7.

Recommendations for Growing the Market for Catalytic Capital – The What Next

7. Recommendations for Growing the Market for Catalytic Capital – The What Next

Social investment has been highly successful at growing and building the resilience of segments of the social economy.

However, if we are to increase the coverage of the social economy in an inclusive way and drive growth, we need to actively embrace the full spectrum of funding tools – grants, catalytic capital, traditional social investment, ESG and commercial investment – recognising each is critical but serves different needs and different audiences.

To ensure funding is allocated appropriately and efficiently, the market needs to be structured in such a way that:

- these pools of funding do not compete with one another;
- there are sufficient pools of each type of capital;
- social purpose organisations can access the pool of capital that is appropriate for their investment needs;
- catalytic capital is deployed only to those social purpose organisations facing a genuine access-to-capital gap; and
- discipline around financial and social returns is not compromised through the provision of catalytic capital.

It is with this in mind that we have developed a range of high-level recommendations to support the growth of the UK catalytic capital market. We have grouped these recommendations under five categories, each of which is outlined below:

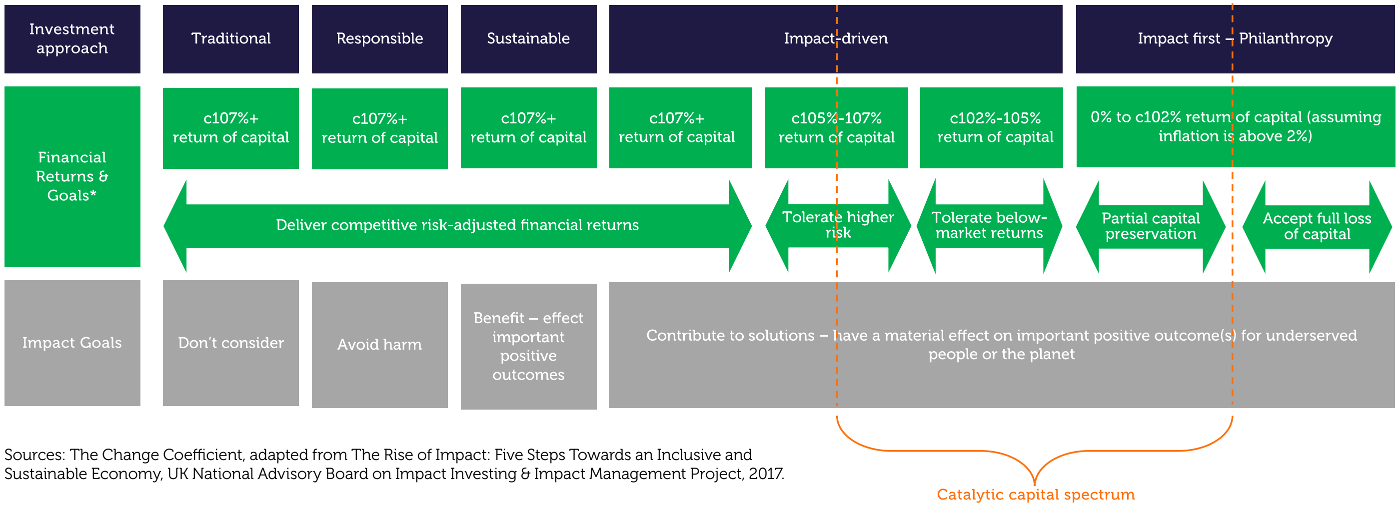
1. Raising awareness of catalytic capital – market building.
2. Building the evidence base.
3. Creating structures to ensure the effective deployment of catalytic capital.
4. Strengthening the link between catalytic capital and impact.
5. Showcasing the impact potential of catalytic capital.

It should be noted that this report seeks to kick-start the conversation on catalytic capital, and not to provide a definitive roadmap to growing the catalytic capital market. These recommendations are therefore a combination of practical measures and starting points for a deeper conversation.

7.1 Raising awareness of catalytic capital – market building

If more stakeholders are to provide the concessionary capital needed to fund catalytic capital, greater transparency is needed on the availability and impact of catalytic capital. We recommend the convening of a large-scale annual conference on catalytic capital, that will include a mix of roundtables, presentations and panels showcasing catalytic capital deployment in the UK. The conference will be accompanied by an annual market report and survey highlighting both current and planned provision. The survey will aim to break down provision by factors such as the type of social purpose organisation funded (legal structure, revenue, profitability and number of employees), the access-to-capital gap addressed, impact areas funded, investee organisational outcomes achieved or targeted, and geographic spread of funding. The survey will also map the target returns of the various catalytic capital funds to showcase the provision of funding across the spectrum of capital, as shown in Figure 23 below, thereby encouraging provision across the spectrum. The conference should be attended by

Figure 23: Spectrum of catalytic capital among the total spectrum of capital provided to social purpose organisations



Sources: The Change Coefficient, adapted from The Rise of Impact: Five Steps Towards an Inclusive and Sustainable Economy, UK National Advisory Board on Impact Investing & Impact Management Project, 2017.

*These are indicative numbers and will vary across investors, investments and over time depending on market conditions.

the widest possible range of stakeholders, including the providers of concessionary capital, commercial investors, impact investors, HNWIs,[28] social purpose organisations, foundations, government and corporate foundations.

The conference and accompanying annual report will:

1. Showcase the inspirational work of social purpose organisations and the power of catalytic capital in developing and scaling sustainable solutions to social challenges.
2. Enable stakeholders to identify gaps in provision by not just reviewing market activity, but also taking a forward-looking approach to new entrants into the market, including new funds, government activity, new funders, and structuring mechanisms or investment instruments.
3. Support the dissemination of best practice on the effective deployment of catalytic capital.
4. Encourage provision of catalytic capital across the returns spectrum, by highlighting gaps in provision and preventing the market from coalescing at either end of the spectrum.
5. Improve transparency on the provision of capital across the funding spectrum, enabling stakeholders to target their capital more efficiently. For example, those with more flexibility around their financing (e.g. HNWIs and foundations) may choose to maximise impact and provide capital that is more concessionary (only some return of capital and no return on capital). 'Conversely, due to their fiduciary responsibilities, pension funds are likely to choose to provide patient or flexible capital or invest alongside other more risk tolerant funders.'

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6. Engage commercial and impact investors at the earliest stages, to ensure when new markets or products are proven, there is a pipeline of commercial capital ready to invest.
7. Showcase forms of catalytic capital that exemplify patience and flexibility, without being concessionary or risk-tolerant, to attract commercial investors into the market. Commercial investors such as pension funds and wealth managers cannot provide concessionary capital, because of their fiduciary responsibility to maximise returns, however they could provide more patient capital to entities with strong credit histories (as is the case with the charity bond market (see case study 11 on page 98).
8. Support better co-ordination of activity and drive the pooling of larger volumes of concessionary capital
9. Firmly establish catalytic capital as an independent asset class within the spectrum of social funding.

To succeed, the conference and accompanying publication will need to engage all stakeholders and attract new stakeholders to the catalytic capital market.

7.2 Building the evidence base

Barriers addressed: lack of data and the trust deficit.

We recommend the development of a standardised data collection template for catalytic capital funds, to help build the evidence base around the economic and social benefits of catalytic capital. The dataset would include measures evidencing the growth and resilience of the social purpose organisation funded, data on their impact, data on their access to capital challenges, and data around the outputs of the fund manager to better understand the support needed by social purpose organisations to access and manage investment.

Given the inherent challenges around collecting comparable impact data across a wide range of social purpose organisations, we propose using a distance-travelled methodology to highlight how catalytic capital has accelerated social impact within each investee (distance travelled would be measured against historic delivery and against expectations). Impact data would focus on the number of service users reached, products sold, and be compared to the historical performance of the social purpose organisation and its targets. We do not propose attempting to collect data to compare impact across investees, as this is not only incredibly challenging but can also lead to unhelpful and limiting comparisons. This data would be made publicly available and be included in the annual report.

We recognise there have been many efforts to collect standardised data within the social investment sector, many of which have struggled due to challenges in comparability, attribution and gaps in the dataset. However, the focus on organisational outcomes and distance-travelled methodologies can address some of these challenges. Furthermore, if this workstream builds on the conference and effectively engages stakeholders from across the sector, it will be easier to gain buy-in and design a simple dataset that advances sector understanding and insights. The dataset is likely to evolve over time, will not be perfect, and will need to be analysed carefully to ensure pre-existing blind spots are not reinforced. That said, it will be a powerful tool in building the business case for funding catalytic capital.

7. Recommendations for Growing the Market for Catalytic Capital – The What Next

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We also recommend the collection of more generic data on social purpose organisations, for example through the Office for National Statistics and by the procurement teams at local authorities, to supplement data collected by organisations such as SEUK. This could help validate the economic and social contributions of social purpose organisations and encourage more long-term interventions from the government in the form of guarantees, relaxations in SITR, or grant funding into catalytic capital funds.

We believe these measures would improve understanding of the impact of catalytic capital and improve the understanding of the social and economic value created by social purpose organisations, encourage more stakeholders to provide the concessionary funding needed to deploy catalytic capital (particularly government), and improve efficiency in the deployment of catalytic capital.

7.3 Ensuring effective deployment of catalytic capital

Barriers addressed: market capacity to deploy catalytic capital, and the trust deficit.

Catalytic capital is not about the relaxation of financial risk metrics; rather it affords the fund manager greater scope to trade financial risk and returns against the delivery of long-term sustainable social impact. Catalytic capital fund managers need to understand the genuine financial constraints faced by social purpose organisations, how taking on investment will positively affect them, and in some cases take a forward-looking view of the social purpose organisation's potential.

To achieve this highly challenging balance, we recommend catalytic capital investment committees (ICs) consider how they balance financial experience with experience of running social purpose organisations and understanding of the targeted impact. We recommend fund managers and asset owners implement measures to ensure committees fully reflect the risk-tolerant nature of the capital. This will drive more efficient allocation of catalytic capital, as it will drive investment to social purpose organisations with the greatest social impact potential. There are many ways this can be achieved; for example at Sumerian, the weekly investment committee is made up only of team members and does not have any external members, thereby ensuring investment decisions are informed by those most accountable for achieving the overall objectives of the UK Social Inequality facility. Similarly, The UnLtd Growth Impact Fund has an impact group sitting alongside its IC, to which the IC reports. The impact group examines deals rejected by the IC and can require the IC to reconsider a rejected deal, if there is a strong impact case.

Evidence on the potential impact of the catalytic capital investment should also be required ahead of any investment decision. This evidence should focus not only on the impact of investment on the social purpose organisation's service users/beneficiaries, but also on the social purpose organisation itself. Just as financial risks are assessed and quantified, so too should the risk around delivery of impact be assessed and quantified.

Steps should be taken to ensure catalytic capital does not crowd out other forms of investment, particularly traditional social investors. One way of doing this is ensuring potential investees have explored commercial or existing social investment options prior to applying for catalytic capital. Where possible catalytic capital funds should work with other investors to be part of a broader

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funding package;

Efforts should be made to ensure the provision of the broadest range of catalytic capital. New catalytic capital funds should therefore consider existing market provision and where the proposed fund fits in terms of:

1. **The spectrum of capital** – is the proposed fund targeting some return of capital or a concessionary return on capital? How well served are social purpose organisations across the spectrum?
2. **Risk** – where does the fund sit on the risk spectrum, which kinds of organisation are least well served by current provision? Could they be better supported by a more risk-tolerant catalytic capital fund?
3. **Patient** – how patient is the fund, how do investment durations, repayment holidays and repayment profiles compare to existing provision?
4. **Flexibility** – how flexible is the fund, how could the fund be more flexible to support the goals of underserved social purpose organisations?

Considering the market positioning of the fund across the four key characteristics of catalytic capital, will ensure the broadest provision, and prevent the crowding out of other investors.

It is important to note, we are not advocating that catalytic capital funds maximise all the characteristics of catalytic capital. For example, a fund manager may choose to create a very large patient fund, that offers close to market returns, is low risk and invests in very large social purpose organisations. This could be as catalytic as a small fund that is highly concessionary and invests in small social purpose organisations. The nature of the fund is less important than how the fund fills gaps in the provision of social investment.

Lastly, we recognise there are highly successful fund managers across the UK already deploying catalytic capital to meet a range of capital needs for social purpose organisations. Most of these fund managers could deploy more funding than they currently have access to. Ensuring the long-term viability and success of these fund managers would go a long way to creating the foundations for a vibrant catalytic capital market in the UK.

7.4 Leverage the experience of social impact bonds to attract more catalytic capital

Barriers addressed: unhelpful language of subsidy, competition for concessionary capital, focus on impact, lack of co-ordination.

Section 4 of this report introduced the concept of impact-linked catalytic capital investment instruments. These are investment instruments with outcome triggers to reduce the cost of investment for social purpose organisations. The delivery of social or environmental outcomes triggers payments into the social purpose organisation (payments are less than the total investment amount), reductions in interest rates or reductions in the debt outstanding. As the world's market leader in outcomes-based contracting, we see significant potential for the UK to leverage its experience in social impact bonds to support growth of the catalytic capital market. We recognise this approach will not work for all social purpose organisations or funders and attempts to apply it too widely could undermine the approach; however, there are clear potential use cases including but not limited to homelessness, social care provision and children's residential care.

Social impact bonds enable local authorities and governments to pay for services based on outcomes achieved, as opposed to services provided. In an environment with significant pressure on budgets, this ability to pay for success, often from cost savings and cost avoidance, is a highly compelling proposition. A similar approach could be applied to investment markets. If a social purpose organisation is looking to raise investment to develop a new service, grow or buy an asset that will deliver cost savings, reduce demand for public services or deliver other quantifiable social benefits, the benefiting authority could make the investment and include outcome triggers that would reduce the cost of the investment to the social purpose organisation. This would result in the economic benefit being shared between the authority and the social purpose organisation.

We recommend identifying two to three impact areas that could generate significant savings or value for local authorities or the government and running six to ten pilots across the UK. We believe these measures could help shift the dialogue around catalytic capital from one centred on subsidy, to a narrative of funding long-term outcomes. Not only is this a more positive frame, it also better reflects the sustainable long-term social value created by investing in successful social purpose organisations.

7.5 Showcasing the impact potential of catalytic capital

Barriers addressed: focus on impact, competition for concessionary capital, and the trust deficit.

In section 6 of this report, we identified the greatest barrier to the deployment of more catalytic capital to be the availability of concessionary capital. We noted that most providers of concessionary capital fund impact areas, and a lack of co-ordination was preventing the pooling of smaller pots of concessionary capital. In response to this challenge, many of the stakeholders we spoke to argued for the creation of a fund or programme that would be co-created by a consortium of stakeholders including social investors, foundations, family offices, HNWIs, social purpose organisations, user groups, corporates, commercial investors and government. The fund would be established to tackle a single large-scale social challenge. The fund by virtue of its scale and having a single impact focus, would be in a strong position to attract a larger pool of concessionary capital from a range of stakeholders including foundations, corporates, HNWIs, local government and others. We acknowledge there are many funds tackling targeted social issues, however where this fund would differ would be in its ability to offer the kind of catalytic capital needed. Be that at highly concessionary rates or high levels of risk tolerance, patience (20 years plus), and/or flexibility. Critically the impact opportunity would drive the investment returns of the proposed fund, rather than the targeted investment returns driving the investment opportunity.

The fund would also provide a framework for effective collaboration. In the barriers section, we noted that trust deficits and concerns about funding private gain can prevent effective collaboration between the providers of catalytic capital, particularly concessionary catalytic capital, and those providing capital with some return requirement. Creating a replicable approach that openly acknowledges the constraints partners have on their capital, and optimises social and financial returns within those constraints, would be very powerful. This will not eliminate the need for providers of concessionary capital to, at times, subside the risk or returns of more commercial providers to increase the overall pool of

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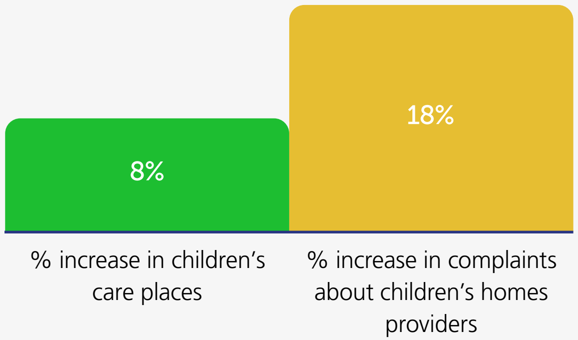
funding, but it will allow partners to better understand and justify the value case, thereby driving effective resource allocation. This approach is exemplified by the Bridgespan Group's work on collaborative grant funding.[29]

Several interviewees highlighted children's residential care and social care as impact areas that could potentially benefit from an injection of catalytic capital. In both cases there is significant underprovision, provision is often of poor quality and suppliers have pricing power. Private firms that have been able to access higher levels of growth capital from private equity, are rapidly taking market share and offer provision of a variable standard. As a result, outcomes are poor, and costs high.

Figure 24: For the year to March 2021, % change in selected statistics for children's residential care services in England



Source: Ofsted

Supporting the development and growth of more social purpose organisations to deliver children's residential care and social care, would have a transformative impact on these markets, delivering better outcomes and increasing competition, which could push up industry standards and save public funding over the long term. The fund or programme would:

1. Showcase the power of catalytic capital to help develop and scale sustainable solutions to deeply entrenched social challenges and deliver social value and significantly improved outcomes for the target cohorts.
2. Create a partnership model, with stakeholders from across the sector contributing expertise and building a funding and support model that has tightly defined outcomes and blends capital effectively to maximise outcomes.
3. Leverage in more commercial capital to the social economy, by bringing in more commercial funders, particularly as the social purpose organisations grow.

We note that Liverpool City Region is currently developing a catalytic capital fund to support local providers of children's residential care, and that there is significant potential for this approach to be used for place-based investment.

8. Conclusion and Next Steps

There is growing recognition of the power and importance of the social economy – that is an economy with social value at its heart. Catalytic capital is a powerful tool to support the growth and development of the social economy and to ensure development is inclusive. However, catalytic capital provision is only one part of a much larger collection of funding and support needed.

This report, as noted earlier, aims to kick-start the conversation on catalytic capital in the UK, and not to provide a definitive roadmap for the market. Many of the recommendations focus on improving the understanding and visibility of catalytic capital, better information sharing, and greater collaboration and partnership working. These recommendations reflect the fact that catalytic capital is currently provided in a sporadic manner, and the institutions and mechanisms we associate with an effective capital market, including the regular flow of funding, a pool of established well-capitalised fund managers, intermediaries and an evidence base on social and financial returns, are missing or lack scale. We believe this creates a unique opportunity to build a market that reflects the financial challenges of social purpose organisations, without losing the financial discipline needed to drive sustainability and ensure the long-term provision of social impact. Collaboration and radical transparency will be required to achieve this goal.

If you are looking to engage with catalytic capital or have any thoughts on the report, please email **catalyticcapital@thechangecoefficient.com**

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3. Hidden Revolution: Size and Scale of Social Enterprise in 2018, SEUK, Co-op Economy Report 2021, Co-operatives UK.

4. The concept of buying goods and services from organisations that are creating social impact, e.g. coffee from Change Please, a bike from The Bike Project, visiting your local community-owned post office or pub.

5. The Reach Fund provided by Access (The Foundation for Social Investment) and funded until 2026, provides support to charities and social enterprises that are close to taking on social investment but require extra support to do so.

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9. For more information on CAF Venturesome's impact see Venturesome: Twenty Years of Impact, venturesome_impact_report_2022.pdf (cafonline.org)

10. In the UK there are few examples of social purpose organisations generating significant returns. Other markets such as India have more evolved commercial venture funds investing in for-profit social purpose organisations, eg Elevar Equity. Significant differences in the two economies and their social infrastructure explain the evolution of their social/impact investing markets.

11. UKRI Strategy 2022-2027

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15. For example, The Missing Middles: Segmenting Enterprises to Better Understand Their Financial Needs, 2018, Omidyar Network et al; The "Missing Middle" is Still Missing, Professor Ingrid Burkett and Professor of Practice Alex Hannant, Co-directors, The Yunus Centre, Griffith University.

16. A Snapshot of the UK Social Investment Market: 2000 to 2021, 2021, Flip Finance, Jess Daggers, David Floyd & Dan Gregory.

17. See also the September 2002 report by the Impact Investing Institute, Bridging capital into communities: A practical guide for policy makers, which considers the effectiveness of grant, guarantee and tax relief subsidy approaches in the UK and internationally.

18. Investors realise an exit from an equity investment by selling the company or their stake to a third party, selling their stake back to the company or through a management buy-out, or listing the company on the public market.

19. Impact-Linked Finance Fund, ilf-fund.org

20. Hidden Revolution estimated 100,000 social enterprises in the UK where these enterprises: (1) had an enshrined primary social or environmental mission (this may be through legal form, governing documents or ownership, for instance); (2) principally directed surpluses towards that mission (i.e. more than 50%); (3) were independent of government (i.e. autonomous of the state, while they may deliver services on behalf of the public sector); and (4) primarily earned income through trading, selling goods or services (i.e. more than 50%).

21. Social Enterprises: Market Trends 2019 report published by the Department for Business, Energy & Industrial Strategy and the Department for Digital, Culture, Media & Sport.

22. Deloitte's In Pursuit of Impact defined a mission-led business as a business that: (1) can fully distribute its profits, with no legal restriction on profit distribution either through a profit lock or through legal form; (2) identifies an intention to have a positive social or environmental impact as a central purpose of its business; (3) makes a long-term or binding commitment to deliver on that intention through its business and operations; and (4) reports on its social impact to its stakeholders.

23. We note a sound investment case is defined differently for catalytic capital investors as compared to social or commercial investors.

24. Kindred spirits: the Liverpool collective redesigning social finance | The Social Enterprise Magazine – Pioneers Post

25. Resilience and Recovery Loan Fund using Coronavirus Business Interruption Loan Scheme (CBILS).

26. Unlocking Private Assets for Impact – How to increase the flow of private capital from wealthy individuals and families to impact-led enterprises in the UK, The final report of the Individual Impact Investing Commission, November 2022 Big Society Capital, The Beacon Collaborative and The Researchery, Report: Enabling an ecosystem that supports increased impact investing by those with private wealth, beaconcollaborative.org.uk

27. ESG funds are portfolios of equities and/or bonds for which environmental, social and governance factors have been integrated into the investment process.

28. The Individual Impact Investing Commission report, Unlocking Private Assets for Impact – How to increase the flow of private capital from wealthy individuals and families to impact-led enterprises in the UK, made similar recommendations around engaging wealthy individuals in the impact investing market. Report: Enabling an ecosystem that supports increased impact investing by those with private wealth, beaconcollaborative.org.uk

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THE CHANGE COEFFICIENT

UK Catalytic Capital
Case Studies

This collection of case studies has been curated in order to bring to life the spectrum of approaches that catalytic capital can take both here in the UK and internationally.

We hope that it proves to be a useful resource for those that are keen to learn more about the usages of catalytic capital. These case studies have been carefully selected in order to ensure that readers of this report have access to the most relevant examples. They contain information both around how these catalytic capital examples are structured, as well as the key information relating to the lessons learnt and the aspects of the approach that relate to taking a catalytic approach. We have also used a breadth of different examples that both showcases catalytic capital deals and funds. We've also included examples from social purpose organisations and social funds that have all benefited from catalytic capital and illustrate the flexible and differing nature of catalytic capital approaches.

For ease, we have categorised the case studies using a UK, Wholesale and International approach to help readers access these effectively. We have also categorised the different types of catalytic capital that these examples fall under in terms of how they are defined from a catalytic capital perspective. For these case studies, it is also worth noting that risk tolerance includes both being risk tolerant (from a financial perspective) but also tackling perceived market risks that exist.

Key of characteristics:

Flexible

Concessionary

Patient

Risk tolerant

Case Studies

The Bike Project – tax relief (SITR) creating a pool of concessionary risk-tolerant capital

The Bike Project's mission	Provide refugees and asylum seekers in the UK with refurbished bikes, helping them to access food banks and other critical services as well as improving their general wellbeing.
Why is the funding catalytic capital?	Loans were provided by supportive individuals to The Bike Project, which were concessionary (3% annual interest with a three-year repayment holiday), risk-tolerant (early stage of the venture), and flexible (loans have been rolled over). These loans qualified for the government's Social Investment Tax Relief scheme (SITR), a tax incentive scheme that allows individuals to reduce their income tax liability in the year of the investment by 30% of the amount loaned. Flexible funding from a foundation via a revenue participation agreement was also obtained.
Investee entity type	Social enterprise (registered charity, company limited by guarantee).
Year established	2013
Impact focus	Refugees and asylum seekers in London and Birmingham.
Investment instruments	Social investment tax relief loans, revenue participation agreement.
Investment size	£170k of SITR funding (five individuals providing £10k each in 2013, £120k from four investors in 2020), £50k revenue participation agreement in 2020.
Investment terms	SITR loans: 3% interest rate, repayable over years 3-5. Revenue participation agreement: one-year repayment holiday, % of monthly trading revenue paid up to capped total repayment of 1.2x loan amount.

Key points

1. The Bike Project demonstrates how SITR can create a pool of risk-tolerant concessionary investment to be deployed as catalytic capital. SITR loans were first secured by The Bike Project in 2017 to help build its ecommerce operations. This funding is flexible and concessionary, as shown by:

- The Bike Project was able to secure £50k of funding in 2017, despite the early-stage nature of the venture and lack of collateral. The use of SITR as a mechanism to enhance the risk tolerance of individual investors, allowed The Bike Project to access catalytic capital from individual investors.
- The Bike Project was able to negotiate a 3% interest rate, well below rates it may have paid on an institutional loan, given the early-stage nature of the venture.
- No repayments can be made for three years under the qualifying terms of SITR. This allowed The Bike Project more time to deliver on its growth strategy and to reinvest profits into the business for longer, before having to make repayments.
- SITR loans are made by individuals who typically have a high degree of flexibility over how long they can hold an investment, unlike most social investment funds that have fixed lives beyond which investments cannot extend. As a result, The Bike Project was able to renegotiate the term of the five original £10k SITR loans, from bullet repayments at the end of year 3 to equal repayments spread across years 3-5. This flexibility also extends to the terms of the loans, and in its most recent SITR funding, The Bike Project was able to negotiate clauses that allow repayments to be delayed or funding restructured, should sales fall short of expectations.

2. The challenge with SITR, is that it is not well known to organisations, and access to a network of individual investors is needed. The Bike Project benefited from the founder's exposure to SITR through a fellowship programme, and his ability to find and attract philanthropically minded individuals to invest in The Bike Project.

Creation and structure

The Bike Project's mission is to take second-hand bikes that have been donated, fix them, and give them to refugees and asylum seekers in London and Birmingham. A bike helps recipients access food banks, legal advice, healthcare, education and other services. A bus fare typically costs £23 per week, over 50% of the £40.85 a week that refugees and asylum seekers receive.

The organisation also runs group cycle training for female refugees, skills and maintenance workshops, and a cycling buddy pairing programme. As well as its charitable activities, the organisation sells some of the refurbished bikes to the public through its online bike shop.

The next step in the organisation's evolution is setting up a flagship store in Camberwell, to encourage more people to collect bikes, generate more revenues through the sale of bikes, and encourage local community engagement. This new retail project has been funded via c£120k of SITR funding and £70k in donations. Access to catalytic capital at the point of need has allowed The Bike Project to secure a ten-year retail lease on favourable terms.

Outcomes

Having received capital in a timely fashion, at concessionary rates with a high degree of flexibility, The Bike Project has been able to grow its business, have the confidence and support to take on new ventures (e.g. new retail and community space that it is developing), and not be distracted by capital-raising issues, which shift focus from operations. The network effects of SITR, where passionate philanthropic individuals have in turn promoted investment in The Bike Project to other philanthropic individuals, have also helped. Catalytic capital has been instrumental in The Bike Project being able to give away over 7,500 bikes to refugees so far, with free service and repairs at any time. Revenues at The Bike Project have increased eightfold in the five years from 2015 to 2020.

The Community Shares Booster Fund – supporting organisations to mobilise communities to deploy catalytic capital

Booster's mission	The Community Shares Booster Programme (Booster) provides institutional investment into co-operative and community benefit societies, alongside and on the same terms as community shares. The community shares (often referred to as comshares) leveraged in give local individuals an ownership stake in local community businesses, while the businesses can benefit from much-needed unrestricted funding that is long term, risk-tolerant, patient and flexible.
Why is the funding catalytic capital?	Comshares, and the matched equity investment from the fund that is made on the same terms, are highly patient forms of capital – the shares are non-transferable and although withdrawable under certain conditions (such as providing sufficient notice), withdrawals tend to be low. Income on shares tends to be low (sometimes zero; highly concessionary) with individuals motivated to invest to support the community, rather than achieve a financial return. Capital tends to be risk-tolerant, with each individual on average investing a small amount.
Year established	2013
Investing entity type	Fund
Impact focus	Local community businesses and assets in the UK
Source(s) of capital	Power to Change, Architectural Heritage Fund
Fund instruments	Equity
Investment size	Up to £100k
Investment terms	Booster matches up to £75k-100k of comshares raised with share capital from the fund. Investment is not transferable, but capital can be withdrawn with sufficient prior notice, usually after an initial period in which withdrawals are not permitted. Booster also offered £10k in grants to support them prepare the community share offer (including costs of the Community Shares Standard Mark).

Key points

1. Comshares are a clear example of catalytic capital – they are patient, concessionary, risk-tolerant and often flexible. Comshares engage local people or people united behind a shared cause as shareholders. These investors are typically motivated by a desire to support the community, rather than achieving financial returns. A small return is typically paid on comshares (i.e. highly concessionary). The shares are not transferable but can be withdrawn after a certain period of ownership. Small sums provided by thousands of supportive individuals ensure the capital is often more risk-tolerant than institutional funding.

2. Booster provides matched equity to comshares on the same terms as the community investors, thereby investing alongside the community and taking on shared risk and benefits. Co-operatives and community benefit societies ("businesses" in the context of this case study) receive matched equity investment from Booster: up to £75k comshares for businesses that are readying their share launch, and £100k for businesses that have launched an offer or will do so shortly.

Creation and structure

Booster was launched in 2013 and is managed by the Community Shares Unit, a joint initiative between Co-operatives UK and Locality. It is currently funded by Power to Change and the Architectural Heritage Fund. In addition to providing equity funding, Booster deploys grants to businesses that need development support to get them to share offer launch and analyses and researches how the comshares model can be applied to new places and sectors to strengthen community businesses.

Outcomes

A 2020 report funded by Power to Change and Community Shares Scotland (Understanding a Maturing Community Shares Market) found that in the less than ten years since comshares began in the UK, more than £155m of financing had been raised from c525 investment raises by over 104,000 people supporting more than 440 organisations. Importantly, 92% of businesses that raised finance were still trading, 85% stated that the share offer had a positive impact on their financial performance, and 80% of people that invested attributed their investment to social or environmental benefits of the organisation (less than 20% cited finance returns as the driver). For every £1 invested in community shares, the report found that an additional £1.18 was leveraged via grants, loans and institutional investment.

Booster has played an important part in this market. For every £1 invested by Booster, on average £2.60 of comshares investment has been attracted. Without the combination of Booster investment and comshares, some of the organisations provided with funding may have been unable to find alternate funding, unable to take risks, unable to deliver the impact they have achieved, and been financially unviable.

Case Study Three - Social purpose organisation case study

Fordhall Farm – catalytic capital deployed as community shares

Fordhall Farm's mission	A social enterprise was set up to save Fordhall Farm from redevelopment and restore it to a sustainable, organic farm with traditional farming techniques to act as a learning centre. Fordhall Farm has since expanded to include a café, farm shop, event days, online store, educational visits, free farm walks and accommodation.
Why is the funding catalytic capital?	The founders were seeking patient capital and wanted to build a community through their investor base, so ran a community share (comshare) issue – selling both equity and loans to individuals on concessionary terms (0% interest), that were flexible (loans often converted to donations), patient and risk-tolerant (funding given when the farm was dilapidated and had little income).
Year established	2005
Investing entity type	Social enterprise (industrial and provident society).
Impact focus	Sustainable food production and education.
Investment instruments	Catalytic capital – comshares (£705k of 2005 funding), interest-free loans (£250k). Fordhall Farm also took on a commercial mortgage (£100k) and received donations.
Investment size	£1.1m in 2005, and follow-on funding of £1.5m+ since. Comshares continue to be sold to new members.
Investment terms	Existing comshares cannot be sold and carry no dividend (but can be refunded upon request contingent on the enterprise having sufficient funding); interest-free loans were for five years (most have been converted to donations), 30-year term for mortgage.

Key points

1. Engaging with a community united by a common cause supports the raising of catalytic capital. In 2005, the Hollins family raised £1.1m to buy and update the family farm it had leased for hundreds of years, saving it from redevelopment. The family did this by creating a community of supporters.

- Fordhall Farm accessed catalytic capital in the form of concessionary and patient comshares – lifelong, cannot be transferred or sold, but are refundable with 12 months' notice (only £2k-4k has been redeemed per year and mostly upon the death of a member). In addition, the organisation borrowed £250k in interest-free loans from members that were repayable after five years.
- Funding was risk-tolerant – at the time of purchasing the farm outright, it was in a dilapidated state following years of funding being diverted to legal expenses to fight potential eviction and redevelopment. The vision to turn around the farm was high-risk and further investment was required beyond the £800k purchase price. Comshares tolerated this risk – over 8,000 members provided £705k of funding, an average of less than £100 per person. Surveys conducted by Fordhall Farm confirmed individual investors were motivated by a desire to support the community rather than for financial returns.
- Interest-free loans have been highly flexible – Fordhall Farm leveraged relationships with members to issue £250k of interest-free loans. When loans came due (initially after five years), Fordhall Farm successfully appealed to lenders to treat loans as a donation and earn Gift Aid (c£180k-190k converted to donations), or to roll them over (c£50k-60k extended the loan duration). The organisation has had to repay just c£20k of its interest-free loans.

2. Catalytic capital filled a clear access-to-capital gap for Fordhall Farm, which has allowed the organisation to focus on its social mission. Fordhall Farm originally explored buying the farm via a normal business loan, to then sell part of the farm to help repay the loan, however that would have gone against the organisation's social mission and diluted its ability to deliver impact. Social investment loans were also considered in 2006, but it was uncomfortable taking on the risk of a fixed interest rate loan, when it had little income from the farm.

Creation and structure

Fordhall Farm is a sustainable, organic farm in Market Drayton, Shropshire, employing traditional farming techniques. It has been home to the Hollins family for over 700 years. The family had leased the land and had been engaged in over 15 years of legal battles with their landlord, who was seeking to evict them, with pressure from a neighbouring international dairy manufacturer wanting to redevelop the land. The organisation was set up as an industrial and provident society for community benefit.

Outcomes

The catalytic capital received by Fordhall Farm helped save the farm from redevelopment. Through the creation of a membership base of comshare owners, Fordhall Farm has been able to access further rounds of funding. Investment has allowed buildings, equipment and the farm to be restored in a sustainable and ecological way. Fordhall Farm now boasts a farm shop, farm kitchen, an event catering business, event spaces for hire, event days (including educational experience days and site visits), a tenant farmer, an online shop and accommodation 'glamping'). Fordhall Farm is now financially sustainable, having been profitable every year since 2015, and has healthy cash reserves that can be reinvested to increase social and environmental impact. During the summer months the 128-acre site can attract over 25,000 visitors and employs over 100 local people.

Case Study Four - Fund case study

Futurebuilders England Fund – catalytic capital supporting the delivery of public services

Aims of Futurebuilders	Futurebuilders was the UK's first social investment fund of scale and aimed to test the ability of social enterprises in England to take on repayable finance (in the form of loans) and become more involved in delivering public services. Investment aimed to improve organisational development, support more effective public service delivery, and improve outcomes for service users.
Why is the funding catalytic capital?	Funding was provided in the form of loans, grants or a blend of loans and grants, depending on the entity's size. The fund served charities and social enterprises, and investees were only slightly profitable (on average). Loans were long term and highly flexible, with interest and/or payment terms varied for almost half of all loans. A 'rescue pot' of money was also established during the financial crisis, to help investees alongside the fund. Interest rates were concessionary, more than 0.85ppts to 2.75ppts below alternate social investment funding.
Year established	2004
Investing entity type	Fund
Impact focus	Social organisations bidding, winning and delivering public service contracts in England, especially in the health and social care spaces (c47% of funding), as well as education & learning (c26%).
Source(s) of capital	UK Treasury
Fund size	£142m
Investment instruments	Loans only (c12%), grants (c3%), and blend of loans & grants (c85%, with 83% on average of the blend being loans).
Investment size	Loans: average £481k, median £219k, range of £16k to £5.3m
Investment terms	Loans were offered at 2.14% above Bank of England base rates, with an average 13.9-year term. Options in some contracts allowed rates to move from 6% fixed to 3% variable, which was subsequently offered to all investee borrowers.

Key points

1. Futurebuilders was a catalytic capital fund that aimed to prove the ability of larger social enterprises delivering public services to take on social investment. Futurebuilders was highly innovative when it launched in 2004, blending grant and investment to create highly patient, concessionary, risk-tolerant and flexible capital.

For the investor:

- There was no portfolio financial return target set at the outset. However, after the fund had been closed to new investments, it set a target of recovering at least 75% of capital invested.
- Default rates (write-offs and provisions) have been relatively low at 18% (as of December 2021), well below the 25% fund target.
- As of early 2019 and with the fund still having a further 16 years until it is closed, £99m had been paid to HM Treasury, including £72m of capital repayments related to the c£117m repayable financing that was provided to investees. Including c£9m of loan write-offs, c70% of the loan book has been closed within the first half of the fund's life.
- On the repayable financing (loan) component, the fund's IRR was +1.2% as at May 2020. Including grant subsidies together with long-term business support and portfolio management costs, the IRR was -8.1%. The fund's manager, Social Investment Business (SIB), expects the IRR achieved to increase further over time.

For investees (and consequently wider social impact):

- On average, investees employed 16% more staff three years after receiving Futurebuilders' investment, and wages also increased;
- Financial resilience improved with revenues, net assets and cash reaching and plateauing at new highs in the three to four years post-investment, while organisations were also sustainable, and default rates lower than anticipated.
- Further funding and refinancing have since been obtained by investees, including funding similar to that for which investees had been turned down before receiving Futurebuilders' investment. Approximately 13% of investees received £96m of further loans and c64% of investees obtained £285m of further grants.

2. Investee selection is one factor contributing to the fund's outcomes. On average, investees had revenues of £712k and were very slightly profitable (£14.5k, 2% margin), employed 30 staff, and had £498k of assets including £110k cash. Following criticism from other lenders that the fund was distorting the market, part way through the deployment period, Futurebuilders introduced a requirement for organisations to show that they had been unable to obtain funding from at least two mainstream lenders. The remit of the fund was to invest in enterprises that others would not.

Investees also tended to operate in geographic areas of highest deprivation, with 41% of investment deployed to the 20% most deprived areas. While one shortcoming of the fund was a lack of impact measurement built into the fund, the geographic profile of its funding suggests it accelerated potential social impact, which is the goal of catalytic capital.

3. The type of instrument offered to investees, blending grants and loans case by case, contributed to Futurebuilders' success. As repayable finance to social organisations was being tested for the first time, the funding by its nature was highly risk-tolerant. The size of the investee largely determined how much funding was grant and how much was loan, with smaller enterprises/charities receiving a higher blend of grants vs loans.

Funding could be grant-only, loan-only, or a mix of grants and loans. Of the c£142m fund, £17m was deployed as loan-only deals (c12%; 27 deals to 26 unique organisations), £4.6m was grant-only (c3%; 189 deals to 183 unique organisations), while the majority of funding was deployed as blended deals (c85%; £120.6m in 179 deals to 175 unique organisations, with loans on average representing 83% of the mix). The table below shows the mix of grants and loans and how higher blends of grants were used to improve affordability for smaller organisations.

Futurebuilders' mix of grants and loans

Organisational revenues > % Grant component	<£100k	£100k-500k	£500k-1m	£1m-5m	£5m+
0%	0%	8.33%	0%	9.09%	43.75%
0%-10%	0%	4.17%	21.74%	21.21%	6.25%
10%-20%	30%	20.83%	17.39%	48.48%	31.25%
20%-30%	60%	33.33%	34.78%	6.06%	0%
30%-40%	20%	25%	17.39%	15.15%	12.5%
40%-50%	0%	8.33%	0%	0%	6.25%
50%-60%	0%	0%	4.35%	0%	0%
70%-80%	0%	0%	4.35%	0%	0%
Total	**5**	**24**	**23**	**33**	**16**

Source: SIB.

4. Funding terms were highly flexible, patient, concessionary and risk-tolerant, with a further emergency fund aligned to Futurebuilders to be used alongside it.

- Very patient – the average loan duration provided was 13.9 years.
- Highly concessionary – the interest rates on average were 5.45%, well below the average 6.3% for secured loans and 8.2% for unsecured loans from alternate social investment fund intermediaries at the time, according to analysis by the Department for Work and Pensions. The average Futurebuilders' interest rate was 2.14% above Bank of England base rates, which today would reflect a rate of less than 3%. Accounting for the grant subsidies that were blended, the rate would be just 0.55% above base rates. Rates were also reduced over time, largely in response to the impact of the 2008/09 financial crisis.
- Flexibility offered – as the fund did not have the ability to recycle funds, it could not provide additional funding to investees. However, it was able to vary funding terms when investees needed help (after the 2008/09 financial crisis). Approximately half (46%) of all deals were varied from their original terms – of these, 68% revised the interest terms, 18% revised payments and just under 14% revised both interest and payment terms. For example, some investment contracts provided the investee with the option to reduce their interest rate from 6% fixed to a more concessionary 3% variable rate. The fund's investment committee decided to extend this option to all investees out of fairness. Ultimately 15% of all investees who received loans utilised this option.
- A separate rescue pot of money (the Monetisation Fund) was aligned to Futurebuilders in response to the challenging economic conditions after the 2008/09 recession and provided to investees that needed help. £1.1m in grants was provided to 35 investees and £7.4m of 0% interest loans to 47 investees.
- Efficient deployment to investees struggling to find funding elsewhere – unlike the due diligence processes for other funding which could be six to 12 months, Futurebuilders provided funds to investees within a relatively short timeframe. The largest grants went to the smallest organisations, including when blended funding was provided.

5. The fund also stands out for the data and evidence base that it has provided, with ongoing research. The fund, with support from DCMS, has tracked and shared the financial performance and statistics of its investees and portfolio. The evidence base shows how catalytic capital can drive growth and sustainability of social enterprises. This could encourage further catalytic capital and help design funds and future financing. Data has also pointed out what has not worked. For example, deals that involved large property purchases that were dependent on renting out part of the property to repay loans, were less successful on average.

6. The collaborative design of the fund has contributed to Futurebuilders' success. Many stakeholder groups were involved, from government to social enterprises. One potential gap in design was more extensively consulting with local infrastructure bodies.

Creation and structure

Futurebuilders was set up following HM Treasury's Cross-Cutting Review of the Role of the Voluntary and Community Sector in Service Delivery in 2002. The purpose of the government-backed fund was to test providing social investment (in the form of loans) to social enterprises in England to help them bid for, win and deliver public service contracts. Futurebuilders invested in 359 organisations across 403 deals. The health sector was a priority, given the favourable commissioning environment at the time, and the health and social care sectors attracted 47% of Futurebuilders' funding.

The fund was managed by a consortium (Charity Bank, Unity Trust Bank, Northern Rock Foundation and the National Council of Voluntary Organisations) from 2004-07, and has since been managed by SIB, which disbursed the remaining funds from 2008-10 and managed the loan book.

SIB believes that Futurebuilders was instrumental in demonstrating social investment could be delivered at scale, and showcased the power of social investment to policymakers, given the government was the investor.

Outcomes

The catalytic capital received by Fordhall Farm helped save the farm from redevelopment. Through the creation of a membership base of comshare owners, Fordhall Farm has been able to access further rounds of funding. Investment has allowed buildings, equipment and the farm to be restored in a sustainable and ecological way. Fordhall Farm now boasts a farm shop, farm kitchen, an event catering business, event spaces for hire, event days (including educational experience days and site visits), a tenant farmer, an online shop and accommodation 'glamping'). Fordhall Farm is now financially sustainable, having been profitable every year since 2015, and has healthy cash reserves that can be reinvested to increase social and environmental impact. During the summer months the 128-acre site can attract over 25,000 visitors and employs over 100 local people.

Case Study Five - Fund case study

Firstport's Catalyst Fund – venture funding

Firstport's Catalyst Fund mission	Create a funding model that closes the funding gap for early-stage Scottish social enterprises.
Why is the funding catalytic capital?	Provides funding for organisations that cannot obtain alternate financing, which is risk-tolerant (high growth potential) and flexible (repayments depend on revenue success).
Year established	2021
Impact focus	Scottish social enterprises without access to alternate funding.
Source(s) of capital	Scottish government provided the fund with concessionary capital.
Fund size	£15m
Required return	The fund is targeting market rate returns on its investments but can absorb lower returns at the fund level to support higher-risk venture investments.
Investment instruments	Revenue participation agreements (quasi-equity)
Investment size	£50k and above
Investment terms	Repayments are typically capped at 1.3-1.5x of the original loan and repaid as 3-4% of monthly trading revenues with a one-year repayment holiday. Investments are typically repaid over seven to ten years.

Key points

1. Several years of research identified the funding gap for c200 social organisations in Scotland each year. These organisations were identified as having the potential to scale and deliver social impact but could not access the social investment needed to do so. Through the business support provided by Firstport and the Social Entrepreneurs Fund, Firstport saw circa 90% of the pipeline of early-stage social enterprises in Scotland (c1,200 per year), and therefore had unique insights as to the access-to-capital gaps faced by social enterprises.

2. Firstport has found that revenue participation with a repayment holiday is an effective instrument for the deployment of catalytic capital. Catalyst Fund investees repay investment as a fixed proportion of revenues with a one-year repayment holiday. The Catalyst Fund invests in enterprises or development projects with high margin potential and works with investees to ensure the repayments are financially viable and will not put undue strain on the business. The revenue share model ensures investor and investee are aligned on growth.

3. The investor in Firstport's Catalyst Fund has provided funding on terms that allow Firstport to deploy catalytic capital, but there are conditions to ensure the efficient allocation of this concessionary funding. Investees typically do not yet have the scale or track record to be able to secure investment. However, to ensure the catalytic capital is efficiently allocated and genuinely meeting access-to-capital gaps, Firstport requires evidence that the investee has been unable to secure commercial investment, typically from their banking provider.

4. Achieving debt-like returns on ventures capital (VC) odds is very difficult. A repayment multiple cap is set at the outset of the loan, based on the financial risk assigned to the borrower, which for an average risk organisation may be 1.3-1.5x. Typically 3-4% of trading revenues (i.e. ex grant income) is repaid each month. The cost is comparable to a ten-year loan with a 12% pa interest rate. While these rates may sound higher than average social investment deals, on a risk-adjusted basis they are concessionary. The Catalyst Fund allows social enterprise models to grow at more modest rates than is typically required by equity investors.

Creation and structure

Firstport is a registered charity and social enterprise, which since 2007 has provided funding and support to social entrepreneurs and social enterprises in Scotland. It aims not only to provide financial support to organisations (including grant funding for socially minded business ideas via its Social Entrepreneurs Fund), but also to help ready them to take on further investment and to improve their processes and financial management through initiatives such as its LaunchMe accelerator programme (for business support and investment readiness). Firstport launched the Catalyst Fund in the summer of 2021, to address the c200 organisations per year it found were falling through the social investment gap.

- **Catalytic capital:** The fund's cornerstone investor is the Scottish government, which provided £15m.
- **Investment allocations:** Each investment is given an overall risk rating, as each rating has a certain allocation at the portfolio level. Financial risk ratings are complemented with ratings that encompass potential impact created, the investee's ability to report on impact, how likely the organisation is to become sustainable and how well it fits within the Catalyst Fund mission, among others.
- **Fund operations:** Organisations send quarterly management accounts to the fund and repay based on the quarter in arrears. If the accounts are not sent (with actual figures), repayments may be based on projections. If estimates are optimistic, it is in the interest of organisations to ensure actuals are sent, otherwise the organisation could overpay. The fund has board observer rights and endeavours to maintain a close and supportive relationship with investees.

Outcomes

The fund currently has a pipeline of c40 businesses that are pre-application. It has made three investments so far in the less than 12 months it has operated – £190k in a biochar water remediation tech business (Sustainable Thinking Scotland CIC), which had been a member of Firstport's investment readiness programme, £50k to build out educational activities and accommodation rentals for an eco-food business (Woodside Arran CIC), and £85k for an ethical garment print and embroidery service business (Wild & Kind CIC) to create jobs and investment in equipment.

Case Study Six - Fund case study

Sumerian Foundation – providing catalytic capital alongside pre- and post-investment business skills support

Sumerian's mission	To support early-stage social enterprises, achieve viable growth and lasting impact at scale, with a focus on those led by people with lived experience and from disadvantaged backgrounds.
Why is the funding catalytic capital?	All investment is in the form of patient and flexible finance, with the nature and terms of each instrument co-developed with the social enterprise to ensure both affordability and suitability with the business model.
Year established	2017
Impact focus	Early-stage social enterprises tackling different dimensions of social inequality in the UK.
Source(s) of capital	HNWIs, Comic Relief, Golden Bottle Trust and Access Foundation
Investee entities	Legal structure agnostic.
Investment instruments	Largely but not limited to revenue participation agreements, profit share agreements and preference shares.
Investment size	Typically of £70k to £140k.
Investment terms	All funding instruments include repayment holidays, all investments are patient (typically seven to 12 years), rates are concessionary by nature of the business models and impact focus, with caps being placed on total capital repaid.

Key points

1. Catalytic capital is deployed as revenue participation agreements, profit share agreements and preference shares, as these instruments typically align with the cash flow profile and business models of most early-stage social enterprises. These instruments are risk-tolerant as well as patient and flexible.

- Based on successful experience in emerging markets, Sumerian recognised a funding gap for early-stage social enterprises in the UK – that were either unable to access investment as they were considered too risky, or else were able to access only fixed rate debt, which lacked the patience, flexibility and affordability they required.
- Sumerian addressed this funding gap through providing a range of 'quasi-equity' instruments (including revenue participation agreements and preference shares structured). The advantage of these instruments is that repayment is linked to performance and cash flow, terms are affordable and concessionary, and no ownership rights are conferred to the investor (unlike traditional equity).

2. Investing in early-stage, high-impact potential social enterprises requires a growth mindset and a transparent process.

- Debt investment is typically based on assessing past track record and evidence of stable cash flow generation, given the focus is less on growth and more on capital protection. Sumerian's view and experience is that an 'equity mindset' is more appropriate to investing in early-stage social enterprises, based on assessing the future growth and impact potential of the business model and the quality of the team to implement this at scale.
- Sumerian always co-develops the nature and terms of any finance with each social enterprise. This helps build understanding of the different types of investment available, as well as ensuring transparency.

3. Pre- and post-investment business skills support is as critical as the type of finance provided.

- Sumerian provides in-house pre- and post-investment business skills support and mentorship, reflecting its own experience of starting and growing small businesses, social enterprises and charities. Typically, the management teams of early-stage social enterprises require help in business strategy, financial management and planning, and thinking about how much and what type of investment they need. Such skills support is provided at a pace suited to the needs of each social enterprise and is key to overcoming the wariness many people have with regard to taking on investment for the first time.
- Offsetting the cost of vital skills support to social enterprises is challenging, given the need to also ensure investment is affordable. Securing subsidy is therefore important, to enable social investors such as Sumerian to provide this essential support to social enterprises, and particularly to those founded and led by people from traditionally disadvantaged backgrounds.

Outcomes

To date, Sumerian has invested in 11 social enterprises located across the UK and is actively seeking to invest in up to 20 further social enterprises tackling different dimensions of social inequality by 2025. Sumerian agrees financial and impact performance metrics with each social enterprise and has recently produced an Impact Report describing key lessons learned, as well as progress against outcomes at the portfolio level.

Case Study Seven - Fund case study using grants to structure a pool of concessionary risk-tolerant capital

The Growth Fund – plugging an access-to-capital gap for small-scale funding

Growth Fund aims	The Growth Fund is a partnership between The National Lottery Community Fund, Big Society Capital and Access, and delivered through a range of social investors. It is designed to provide the finance that charities and social enterprises need for growth or diversifying their business models. The fund is aimed at organisations that are unlikely to have taken on social investment before. The fund aims to address the lack of unsecured, affordable small-scale funding (up to £150k) for English charities and social enterprises. Funding is deployed through social investors and supports the development and growth of social investors.
Why is the funding catalytic capital?	The programme is designed around a market gap. It supports the operating costs of fund managers, which would otherwise have been passed on as higher interest rates or prevented the loans being made at all. Investees are provided with a risk-tolerant, concessionary blend of grants and unsecured loans. The blend also helps lower effective interest rates to investees, which often makes the lending possible. Fund managers are provided with a first-loss layer of grant capital for defaults, allowing them to make more risk-tolerant investments.
Year established	2015
Impact focus	English charities and social enterprises needing small-scale funding (up to £150k) in any sector.
Source(s) of capital	The National Lottery Community Fund (NLCF, c£21m concessionary capital in the form of grants), BSC (c£20.2m investment capital requiring a return) and some other sources of loans fund the programme (c£1.5m).
Fund size	c£43m.
Investment instruments	Loans or blend of grant and loans.
Investment size	Maximum £150k (grant + loans), average £67k (of which 16% is grant).
Investment terms	Loans are unsecured, with an average interest rate of 7.2% (5-12% range) for an average repayment term of 4.25 years (typically ranging from three to six years). Maximum grant component of funding provided is 50% (typically 15-30% of investment is grant, and 73% of loan recipients receive a grant component). (Data as of September 2021.)

Key points

1. Funding is designed to fill an access-to-capital gap for charities and social enterprises. The programme was designed in 2014/15 and seeks to fill a gap in the provision of small <£150k, unsecured loans to charities and social enterprises. The programme focuses on supporting charities and social enterprises taking on investment for the first time and in the early stages of developing or growing trading revenues.

2. Blending capital with a positive return requirement (+c5%) with grants creates a pool of concessionary, risk-tolerant capital. BSC provided c£20.2m of loan capital and NLCF provided c£21m of grants to the programme. This money, which is managed by Access in a wholesale capacity, funds 16 blended finance/catalytic capital funds run by 14 social investors. In turn, these 16 funds provide charities and social enterprises with blended grant and loan investment. Funds are provided to each social investor in three pots for specific purposes. Grant A is an operating cost subsidy for social investors to support the additional cost of making small loans; Grant B a fund-level grant blended with debt from BSC to increase the risk tolerance of the fund and act as a first-loss layer; and Grant C a deal-level blend for investors to provide discretionary grants to investees alongside their loans.

3. The financial challenge of delivering small loans at affordable rates is addressed through Grant A. Grant A supports the fund manager's operating costs. This is needed as operating costs as a proportion of the investment are higher when making small loans, as compared to making large investments. This is because costs per loan such as marketing, due diligence and loan management are largely the same regardless of loan size.

Each fund manager was initially permitted no more than 10% of its grant funding in the form of Grant A (as of September 2021 the average was c9%, a grant of £120k, with the range being £49k to £200k). The subsidy aims to cover the cost of setting up funds and the cost of deployment prior to investments generating sufficient fees and repayments to cover operating costs.

4. First-loss grant layer enables more risk-tolerant capital to be provided to investees. Grant B provides a first-loss layer to fund managers to cushion defaults on investee loans, so that fund managers can repay BSC and other investors who require a positive return on their investment. BSC lent capital at a 5% interest rate. With the onset of Covid-19, BSC has since reduced its rate. Grant B represents 29% on average of the total fund size (loan + Grant B). As of 31 December 2021, only 7% of the aggregate portfolio has been reported as in default – £2.49m out of £35.2m (these figures exclude Grant C).

5. Grant funding is also provided at the deal level to improve affordability. Grant C enables social investors to deploy grants alongside investment at the deal level. The grant component of the investment provided by fund managers to investees cannot exceed 50%. Apart from these conditions, Grant C is highly flexible and discretionary. Almost all fund managers have reported providing blends of loans and grants to investees on a case-by-case basis, which on average represents 15-30% of the investment provided. Some grants are offered on a repayable basis, as flexible, quasi-equity with repayment linked to achieving certain performance targets, while the vast majority are non-repayable. Fund managers acknowledged that the blend helped reduce interest costs for investees (concessionary). Grant C enabled greater focus on impact.

6. Key learnings and evidence from the fund (deployment of the Growth Fund ran to 2022/23) highlight the need for more flexibility around the use and timing of grant funding. Key points included:

- Fund managers suggested that having three pots of grant with restricted use means the programme is complex and somewhat inflexible. While this may be true, some boundaries around the use of grant funding are needed to support the design process and ensure efficient use of concessionary capital. Furthermore, a degree of standardisation supports effective data collection and evaluation.
- Not having the flexibility to deploy more grants to investees than was originally budgeted and received as Grant C, may have partly limited the flexibility of funding to investees. However, the partnership has responded with post-investment growth support and Covid-19 business support to investees (at their social investors' discretion).
- Some fund managers stated that limiting the amount of Grant A subsidy for operating costs and the time within which it could be drawn down, meant that deployment has been the main driver of activities and decisions, limiting the scope for innovation and post-investment support. The partnership has acknowledged that it would be helpful in future to allow more flexibility in terms of operating costs subsidy and the time for which this is available.

Outcomes

Evidence from the Growth Fund, including independent evaluations, suggests that the blend of finance is helping to address the access-to-capital gap for small, unsecured lending. Funding is flexible and risk-tolerant, and potentially more concessionary than alternative funding (if any) that charities and social enterprises would have been able to obtain. With its continued monitoring and growing evidence base, the programme should help build a better understanding of which parts of the market can support investment at certain levels of subsidy.

As at March 2020, the 16 investment funds have achieved a mixed performance, with six outperforming deployment targets, six underperforming before being reprofiled or restructured, and four funds not being able to achieve deployment targets (all were new to social lending). Five funds had been restructured including one being closed, while two funds have been reprofiled with a higher fund size.

As at the end of September 2021, the programme has funded more than 500 social enterprises across more than 600 investments to date, with £40m of investment deployed. The median investee has £230k of revenues and five employees, and 28% receive Reach Fund or other capacity building support. The average investment size is £67k (16% of which is given as a grant on average, with 73% of recipients receiving some grant) with an average loan term of 4.25 years and 7.2% average interest rate. The geographic regions that have benefited most are the North-West and South-West, and a disproportionately high number of investments have been made into organisations in areas of higher deprivation.

Esmée Fairbairn Foundation – highlighting the importance of organisational culture in the effective and efficient deployment of catalytic capital

Esmée Fairbairn Foundation's mission	The Esmée Fairbairn Foundation (Esmée) aims to improve our natural world, secure a fairer future, and strengthen the bonds in communities in the UK. Esmée does this by taking an impact-led approach to all of its activities and contributing all that it can to unlock change by people and organisations with brilliant ideas who share the Foundation's goals.
Why is the funding catalytic capital?	This case study focuses on the social investment facility that was carved out of Esmée's endowment. The facility has an impact-first culture with investment often being more concessionary, risk-tolerant (subordinated positions, investing when others won't), patient (longer term) and flexible (restructured during the life of the loan/extended beyond the initial term).
Year established	1961; first social investment made in 2008.
Investing entity type	Charitable foundation and one of the UK's first social investors.
Source(s) of capital	Foundation endowment, with a carve-out for social investment.
Fund size	£45m social investment carve-out.
Required returns	Below-market, average return on investments exited has been 2%.
Investment size	£100k to £2m (average £437k).
Investment terms	Often more concessionary (including rates), patient (e.g. ten years) and flexible (e.g. around rates) than other funders.

Key points

1. Esmée's impact-first culture drives its decision-making and use of catalytic capital. In 2008, Esmée carved out £45m from its £1bn endowment for the purposes of social investment. This carve-out has been invested with a clear impact-first approach, which is embedded in the organisation's culture.

- Flexible approach to the type of funding needed – Esmée believes the key to its success has been adopting an impact-first mindset, understanding the issue which needs to be resolved first, and then developing solutions around it with an appropriate funding instrument (including equity-type instruments as well as loans).
- The organisation's culture is based on trust and a 'just get it done' approach. It adopts a risk-tolerant, impact-first mentality – it often funds the unusual and go where others are sometimes unwilling to go. To enable it to do this, the team tries to maintain a balance between low-, medium- and high-risk investments within the social investment portfolio. The current portfolio is split broadly equally among these three levels of risk.
- Flexible when circumstances change – Esmée's investment team consists of three individuals, managing over 80 investments. The size of its team and the culture allow the foundation to pivot when an investment is not working, and to make changes quickly. The staffing of an internal social investment programme providing catalytic capital effectively is a key consideration for foundations.
- There's a focus on simplicity, with easily understood financial solutions and reporting requirements, good communications and a mutual understanding of expectations.
- The foundation can take more subordinated and risk-tolerant positions in an investee's funding structure, or provide funding on more concessionary terms, than others. For example, in 2020, Esmée provided the affordable credit provider Fair for You with innovative funding in the form of a perpetual bond – in this case, capital that is repaid at the borrower's discretion.

2. The organisation benefits from its years of experience as one of the UK's first social investors, constantly applying learning to improve, and sharing its learning with the market to drive social outcomes.

- Sector expertise helps identify market funding gaps – Esmée's social investment pipeline benefits from the sector expertise of its grants team, which helps identify gaps in the market and the open sharing of these ideas with the investment team.
- The foundation uses development grants upfront, to ensure that organisations do not take on social investment before they are ready, and the co-design of solutions helps to form a closer relationship with the investee at the outset.
- Other funders that are not as risk-tolerant will often signpost organisations to Esmée. Many early-stage ideas tend to come directly or indirectly from Esmée's network.
- For Esmée, learning is crucial – there is a culture of reflect, learn and improve. Outcomes are used to prompt learning, which is then applied to future investments. Some of the questions that the team considers, are whether it has used the right form of capital to enable the change it was seeking, whether it is taking enough or too much risk, and how it can better support its portfolio.
- One of the lessons that Esmée has learned with the benefit of having started back in 2008, is the inflexibility of some loan structures, and especially the need to be flexible in the early years of an investment. It now counts just 8% of its capital in debt products with fixed terms.
- Esmée often shares its learning with the market, providing reports and insights that can be useful for new and existing social investors, as well as foundations interested in social investment. For example, Esmée has reported back on what it has learned over the last five years in place-led funding, its first perpetual bond structure, and has also commissioned and shared research (e.g. impact-linked finance).

Creation and structure

The Esmée Fairbairn Foundation was founded in 1961 and is one of the UK's largest independent grant-makers and social investors. Its three main aims are to improve our natural world, to secure a fairer future, and to strengthen the bonds in communities in the UK.

It is one of the first UK foundations to formally make social investments (alongside traditional grant-making), following a £45m carve-out in 2008. Its small investment team leverages expertise both within and outside the foundation.

Esmée is known for being innovative and catalytic, leveraging in funding from other investors, often willing to be more risk-tolerant than other investors, and providing its investees with appropriate forms of capital that are patient, flexible and concessionary.

Its social investment strategy is designed to contribute to its impact goals and focuses on three objectives: 1) impact-first direct investments; 2) influencing the social investment market; and 3) learning and sharing.

Outcomes

The team typically invests c£5m per year and has made over 150 social investments since 1997. With its impact-first approach, Esmée's financial objective is to break even across its portfolio, which is made possible as overheads are covered centrally. Its culture, structure and funding have allowed Esmée to take on more risk than other social investors, providing capital that is often more patient, concessionary and flexible.

Historically, Esmée's social investments have generated a 2% return across 93 exited investments. More important for Esmée, is the significant impact it has delivered..

Ethex and Energise Africa – the benefits of catalytic capital to drive innovation and growth

Ethex's and Energise Africa's mission	Provide a marketplace for purposeful organisations operating in the UK (Ethex) and Africa (Energise Africa – EA) to raise investment from individuals (i.e. crowdfunding from retail investors).
Why is the funding catalytic capital?	Energise Africa obtained financing in two forms. A contract for services (£750k), which provided start-up finance from UK Aid (managed by E4I) and a pot of highly catalytic investment finance that was flexible, risk-tolerant and concessionary. This investment was endowed to Energise Africa as a grant and was of a sufficient size to avoid repeated smaller capital raises. Funding has been used for match funding, first-loss and scale-up activities. In parallel, P4G supported EA through significant grants through its start-up and scale-up programme and is looking to an equity round under P4G's new (and as yet unannounced) P4G invest scheme. Ethex received development grants to establish itself. However, in general funding has not been sufficient to avoid repeated capital raising. Funding has been less flexible than Energise Africa received (though the threshold for capital repayments has been increased). Most foundation investors provided patient capital (ten years).
Year established	Ethex: 2010 (platform launched in 2013). Energise Africa: 2016 (platform launched in 2017).
Investee entity type	Ethex: not-for-profit social enterprise (company limited by guarantee). Energise Africa: for-profit social enterprise (company limited by shares.
Impact focus	UK and Africa, across all industry sectors.
Investment instruments	Ethex: loans. Energise Africa: grants.
Investment size	£650k in total funding for Ethex. Energise Africa: £650k P4G and £2.5m UK Aid grant (excluding initial contract for services).
Source(s) of investment	Ethex: Foundations and BSC Energise Africa: Virgin Unite, UK Aid, P4G Partnerships
Investment terms	Ethex: loans included a minimum revenue level that triggered capital repayments. ten-year terms. Typical 6% interest rate. Currently being renegotiated. Energise Africa: Grants with business and impact targets.

Key points

Ethex launched in late 2013 as a platform for UK retail investors to buy or sell shares in ethical non-listed companies. The model quickly shifted to helping raise money for organisations, whether that was equity, debt or other forms of financing, and now offers both services. Sister platform Energise Africa was set up by Ethex and Dutch crowdfunding platform, Lendahand, in 2016 to focus on social enterprises and profit-for-purpose organisations operating in Africa.

1. The two platforms are exemplars of the impact catalytic capital can have on the growth and development of social purpose organisations.

- Technology companies like Ethex and Energise Africa often require significant upfront investment (to build platforms and architecture) and the path to breakeven and sustainability can be lengthy. Therefore, 'tech for good' business models typically require risk-tolerant, flexible, long-term patient funding at scale.[30]
- As a not-for-profit company limited by guarantee, Ethex's legal structure prevented it from raising equity, which would have offered the requisite patience and risk tolerance. Its first social investment came from loans from several foundations and other institutional investors. The loans were structured so that the principal was repaid only if revenue was above a certain level. While this was positive and allowed a degree of risk sharing, Ethex found that it was unfeasible to scale up and repay capital when the revenue trigger was reached. It had to restructure the revenue trigger point for repaying capital, as well as later secure a repayment holiday. The debt it received was patient (ten-year term) and while there was some flexibility in the instrument, it was not sufficient for Ethex's needs.
- While there were elements of catalytic capital in the funding that it had received, it was insufficient to take the business model to sustainability. When Ethex has sought further funding, debt has been the instrument on offer. But after lengthy due diligence processes, loans have been rejected by potential funders' investment committees due to perceived risk of piling 'debt upon debt'. Having to repeatedly obtain or renegotiate funding has been a distraction for management and impacted growth.[31]
- In comparison, the Energise Africa platform was set up as a company limited by shares, enabling the organisation to raise equity. Moreover, it has been well funded with appropriate funding from the outset that was highly flexible, concessionary and risk tolerant. Energise Africa received funding from Virgin Unite and UK Aid to help with platform set-up, as well as funds to invest as match funding or provide a first-loss layer for projects on the platform. This funding was later endowed to Energise Africa. While the endowment came with conditions, it can be used flexibly and is of a substantial size, helping Energise Africa avoid a constant cycle of seeking further finance, and being able to adapt to a fast-moving external environment.
- Energise Africa has gone on to secure concessionary finance in the form of a recoverable grant from P4G Partnerships, to build out new services on its platform (e.g. currency hedging and local currency lending). The flexible funding had an original term of two years but was extended for a further two years and came due at the end of 2022. The tangible impact of the platform with over £30m deployed across 15 African countries has led to EA being an exemplar for UK Aid and P4G. It will now rebrand as Energise Earth and expand to fund more impactful organisations across other regions.

2. Ethex and Energise Africa have helped facilitate significant new funding to UK and African purposeful organisations from an untapped source.

- Ethex currently focuses on social enterprises and activities in the UK, while its sister platform focuses on Africa. The two platforms have collectively raised more than £130m of social investment for impactful organisations, representing an impressive 154x leverage.
- Not only have the platforms leveraged in significant funding for purposeful enterprises, but this funding also represents an untapped, new source of funding for the social sector (retail investors).
- Crowdfunded retail money invested via the platforms tends to be patient (eg ten to 15-year terms for loans are common), often at concessionary rates (0-3% rates are common), and risk-tolerant (often funding very early-stage ventures, and largely unsecured).

Outcomes

By 2020, Ethex and Energise Africa had raised more than £130m combined for purposeful enterprises across more than 200 projects via a network of over 20,000 retail investors. More appropriate capital for Ethex could potentially have driven even greater social impact. In contrast, the more favourable and generously sized funding for Energise Africa has allowed management to take risks, such as its project to build new currency hedging and local currency lending services, which have benefited the business and are delivering impact.

Case Study Ten - New investment fund case study

The Fair by Design Fund

Ethex's and Energise Africa's mission	The Fair by Design Fund, managed by Ascension, was set up to invest in scalable companies tackling the 'poverty premium'. An estimated 14.3 million people (22% of the population) in the UK are living in poverty. People in poverty or on low incomes pay on average £490 more each year for the same goods and services as people who are better off financially. For one in ten, this number is at least £780 and some low-income households can end up paying in excess of £2,250 per year when high cost credit comes into the equation. This is the 'poverty premium' – the extra cost of being poor. It's a real and unfair problem, worth over £3.8bn per year in the UK alone. The fund achieves its mission by investing in early-stage, highly scalable technology businesses working to reduce costs across key sectors: energy, financial and digital inclusion, food/health and household, mobility and insurance. It looks for innovations that can scale commercially to the pace and scale of typical venture-backed business, while tackling both the drivers and effect of the poverty premium.
Why is the funding catalytic capital?	Wholesale investment into the fund was both risk-tolerant and patient. While the fund had a clear investment thesis, the concept was unproven – involving an element of uncertainty on the types of business model that would make up the portfolio, and therefore making it hard to predict the return profile. The focus on early-stage, equity investment also increased risk as compared to many social investment funds. The fund was a case study of how a partnership-driven model focused on a clear thesis can galvanise support beyond capital (several LPs have since then opened commercial routes to market for the portfolio). In addition, the fund's pre-seed stage investment helped bring early-stage innovations to a point of traction sufficient to attract subsequent commercial co-investment from downstream investors. The fund's catalytic role was twofold in those cases: 1) it provided for a higher level of risk for very clear, relevant impact propositions which the investment team believed could scale commercially with funding support; and 2), for those pre-seed rounds that were competitive, it allowed the fund to introduce the idea of the impact mission in the founders' brand and value proposition much earlier in their investment journey, thereby influencing the direction of the business in terms of the audience served.
Year established	November 2017 with a ten-year term (deployment started in January 2018)
Sources of capital	Big Society Capital and the Joseph Rowntree Foundation provided £8m, which was the cornerstone of the initial fund, with the team raising another £2m via a second close (including Social Tech Trust, Bank Workers Charity, Barrow Cadbury Trust, Comic Relief, Merchant Taylors Livery Company, Trust for London and HNWIs). A fund extension in 2020 welcomed Nation-wide Building Society as a new cornerstone investor along with the Esmée Fairbairn Foundation and Edinburgh University. The fund has a total of 14 limited partners.

Fund size	£14.7m of which £5m was provided by one of the cornerstone investors, BSC. In 2020, BSC then topped this up by £1m to a total of £6m.
Investment instruments	All investment into the fund can be considered catalytic capital. The fund was able to provide equity and debt, however based on the investment propositions seen so far, the team decided to focus on equity instruments only, given the type of risk/return profile of the deal flow presented to it. The fund invests at pre-seed and seed, and follows on as appropriate to Series A. In some cases, equity is provided through convertible loan notes.
Investment size	Average investment size over the life of the fund to date is £400k, with an expectation that the fund will participate in multiple rounds of fundraising. Initial average investment size is £280k.

Key Points

Research originally commissioned by the Joseph Rowntree Foundation[32] found that on average, low-income households pay an extra £490 a year for basic goods and services. This additional cost was termed the 'poverty premium' and the foundation set about building a coalition of partners to eliminate it. The result was the Fair by Design venture fund and accompanying campaign. The fund aims to remove this additional cost by funding high-impact scalable technology ventures; the campaign creates awareness and advocates for changes in policy and regulation.

The multi-sector partnership works across four pillars:

- Ascension, which has a considerable track record in venture investing and venture ecosystems, manages the fund.
- Barrow Cadbury campaigns to influence policy and regulation, as well as to build public support.
- Toynbee Hall embeds the views of experts with lived experience into the investment process.
- Comic Relief supports the team on roadshows to build awareness of key innovations among regional decision-makers.

1. Catalytic capital was critical in establishing the Fair by Design Fund. The Fair by Design Fund's theory of change was clear and indicated significant impact potential, while research into potential investees highlighted demand for this form of capital. That said, the innovative nature of the fund meant there was less evidence as to the fund's ability to generate market-based returns. This was compounded by the fact the fund planned to invest in early-stage social ventures, a market that is inherently risky. The fund therefore required risk-tolerant capital to prove its financial viability and ability to generate sufficient returns.

The fund invests primarily through equity investments. This is necessary, given the early-stage nature of the ventures and their need for flexible patient capital. The wholesale investment into the fund therefore had to be patient and flexible.

2. The well-evidenced impact thesis helped attract a range of catalytic capital investors. The Fair by Design Fund and accompanying campaign had a very clear, well-evidenced theory of change. Impact is measured by the reduction in the poverty premium for each venture, and how many lower-income consumers are benefiting from the reduction in that poverty premium. It is not possible for all catalytic capital funds to have such simple and clear outcome metrics. However, the clarity of the fund's mission and clarity around venture level outcomes were undoubtedly helpful in pulling together an impressive coalition of partners and funders.

The ambitious nature of the fund in targeting the elimination of the poverty premium, was also likely to have stirred the imagination of potential partners and inspired collective action.

3. The fund highlights the value of systems thinking when designing or making catalytic capital funds or investments. The Joseph Rowntree Foundation and its partners, many of whom have decades of experience tackling poverty and social issues in the UK, identified the need for a holistic systems approach to tackling the poverty premium. Multiple workstreams were identified that would support one another to maximise impact. The approach included: ensuring effective representation for those with lived experience to validate the solutions of potential investees and provide insights throughout the investing and portfolio management process; raising awareness of the poverty premium to encourage new market entrants and behaviour change from large existing providers, for example advocating for social energy tariffs; and advocating for regulatory change.

Outcomes

As of Q2 2022 the fund has invested in 23 companies, benefited1.7m people, and delivered £203m of savings annually for low-income households.

Investees include Wagestream, a financial wellbeing app, marketed to employers, which provides employees with the financial tools to achieve financial resilience through budgeting, streaming, learning and saving features, and Kettel Homes, which helps people build the required deposit and credit history to buy a home.

Case Study Eleven - Developing and growing a market case studystudy

Big Society Capital's investments into the charity bond market

BSC's mission within the charity bond market	Big Society Capital sought to support the growth of the charity bond market, by creating a backstop facility for charity bonds managed by Rathbones, to encourage more issuances and build an exemplar fund to highlight the financial and social value of charity bonds.
Why is the investment into the fund catalytic capital?	BSC's investment aimed to stimulate growth in the charity bond market by reducing real and perceived risk. BSC's capital reduced the risk of bonds failing because they did not reach their fundraising target, while at the same time reduced the perceived risk of charity bonds by successfully investing in them and creating a financial track record for charity bonds.
Year established	2013
Sources of capital	Big Society Capital and capital from Schroder BSC Social Impact Trust
Fund size	Total current commitments from BSC £32.4m, peak commitments from BSC £50m pre-pandemic.
Investment instruments	BSC funds are invested in charity issued bonds that are typically five to ten years in duration with a 4.01% average yield. Proceeds are primarily used for large infrastructure projects.
Investment size	Average charity bond issue size £10.7m – average investment into a charity bond issue made by BSC £1.5m.

Key Points

Since the first charity bond was launched by Triodos for Golden Lane Housing in 2003, the market has grown to an estimated £440m and now attracts a diverse range of investors, including pension funds and wealth managers. Today charity bonds are recognised as an investment that provides both risk-adjusted returns and social impact; however, this was not always the case.

BSC was instrumental in growing the charity bond market

As with many new instruments, charity bonds suffered from a lack of investor understanding and awareness in the early years of their development. Consequently, it wasn't until 2011 that a second was issued. BSC identified the financial and mpact potential of charity bonds and sought to catalyse further investment into the market by:

- Proving the financial viability of charity bonds – BSC through its charity bond portfolio sought to build an exemplar track record, to demonstrate the perceived risk of charity bonds was higher than the actual risk. BSC initially assumed a 7.5% overall rate of defaults, given the lack of historic data, however the current real default rate has been just 2.9%.
- Charity bond issuances average £10.7m per issue, are funded by multiple investors and are typically used for infrastructure projects. In the early stages of the market there was therefore a risk that issuances might fail if they could not attract sufficient investors. BSC's capital was used to create a backstop facility, to give confidence to both issuers and investors that bonds will reach their target.

Outcomes

The primary outcome of BSC's wholesale catalytic capital investment into the charity bond market, has been to support significant growth in the market from £5.4m in 2012 to £440m in 2021. Intermediaries including Triodos and RCB Bonds have also been instrumental in attracting a range of new investors. New investors include pension funds, retail investors and wealth managers, many of whom are conservative in their approach to financial risk. Given the flow of new capital into the charity bond market, BSC's capital is now rarely needed to support bond issues, and some bonds are even oversubscribed.

The range of charities issuing charity bonds has also grown. While most issuers of charity bonds support disadvantaged communities and individuals, some, such as the Canal & River Trust, serve a broad base. Most charity bonds, by value, have been issued by organisations in housing (55%) and physical health (14%).

Case Study Twelve - New investment fund case study

Schroder BSC Social Impact Trust plc (SBSI)

Schroder BSC Social Impact Trust's mission	The Schroder BSC Social Impact Trust aims to deliver measurable positive social impact, as well as long-term capital growth and income. Through a diversified asset allocation, it seeks to provide low correlation to traditional quoted markets, while addressing significant social issues in the UK.
Why is the investment into the fund catalytic capital?	The trust was designed to provide access to high-impact private markets, investments not available to individual investors in public markets, including closed funds, secondary and co-investment opportunities. In recognition that individual investors increasingly want their money to have a positive impact on society, Big Society Capital partnered with Schroders – and provided a seed portfolio of investments – to create a publicly listed investment trust that democratises access to these high-impact opportunities. Ultimately aiming to attract and enable a new pool of investors. While the trust targets market returns, the fund's initial investors took on the greater risk associated with a new IPO in order to help catalyse the significant impact achievable by scaling the trust over time.
Year established	The trust began investing on 22 December 2020.
Sources of capital	The trust was seeded with an initial portfolio of Big Society Capital investments and investment from Schroders and Cazenove. The trust raised £75m at IPO in December 2020. In November 2021 the trust raised a further £10.8m through a share issuance to a mix of new and existing shareholders. Shareholders of the Trust now include wealth managers, a local government pension scheme, a donor advised und, designated Impact funds, family offices and multi-asset managers.
Fund size	As of 30 June 2022, the trust's net asset value was £89.9m.
Investment instruments	The trust invests in a diversified portfolio of private market impact funds, co-investments and direct investments. The trust invests primarily in three asset classes that were selected to give a diversified set of opportunities: • debt for social enterprises • high-impact housing • social outcomes contracts
Investment size	As of 30 June 2022, the Trust was fully committed to high-impact assets across ten investments – eight direct holdings in funds and two portfolios of investments (a portfolio of nine charity bonds and a portfolio of co-investments in three enterprises). Investments range from c£4m to c£15m, with the Trust's largest investment in Bridges Evergreen Holdings – a patient capital vehicle that makes equity and quasi-equity investments into highly impactful businesses. Investments that are committed but not yet drawn by private market funds are held in listed liquid ESG investments, to mitigate cash drag during longer drawdown periods. As of 30 June 2022, c20% of the trust's assets (£16.8m) was held in liquid ESG investments.

Key Points

1. The need for a listed impact investment product. In designing Schroder BSC Social Impact Trust, Big Society Capital – the portfolio manager – considered there to be market recognition that social impact is better delivered investing in private markets. There was also recognition that investors increasingly seek a positive impact on society with their investments – a survey by Schroders found this to be the case for 70% of investors.

However, access to private market impact investments often means having to access limited partnership fund structures, and this is a genuine barrier for retail and private investors, as well as many UK wealth managers and financial advisers. There is also limited investment expertise in private market impact investing, with investors facing high minimum investment constraints, prohibitively long ramp-up periods and concentration risk.

In light of this, Schroder BSC Social Impact Trust is intended to provide a new and unique proposition, opening access, with a liquid vehicle, to private impact markets for wealth managers and advisers in the UK. By overcoming some of the barriers to high-impact private market investments – such as long ramp-up periods, minimum ticket size, the governance burden of managing drawdown requests – the trust aims to attract new investment from a wider pool of investors previously unable to access this market. While the trust targets market returns – the fund's initial investors, of which Big Society Capital was the lead, took on the greater risk associated with a new IPO, to help catalyse the significant impact achievable by scaling the trust over time.

Outcomes

As of 30 June 2022, the trust has raised £89.9m from wealth managers, donor-advised funds and local government pension schemes – fully committing this capital across ten impact investments.

The trust has financed 160 organisations, benefiting more than 160,000 people, at least 90% of whom are disadvantaged and vulnerable.[34]

Case Study Thirteen - Funder case study

Reall Limited – transition to a replicable catalytic capital model to maximise impact

Reall's mission	Reall's remit is to build climate-smart, affordable homes in Africa and Asia (with five focus countries – Pakistan, India, Nigeria, Kenya and Uganda), and to stimulate markets for climate-smart affordable housing.
Why is the funding catalytic capital?	Highly flexible funding with loans converted to grants in certain cases (e.g. very significant depreciation of local currency in which the loan has been made) and concessionary interest rates. A small number of grants in the funding mix also deliver concessionary funding. Loans are risk-tolerant, not just because of the operating conditions of the countries within which they are given, but also because loans are provided in local currency, exposing the investor to currency depreciation.
Year established	Reall Limited was established in 1989 as Homeless International, and over the last decade has transitioned to providing loans from non-repayable grant funding.
Investing entity type	Registered charity (company limited by guarantee)
Source(s) of capital	Foreign, Commonwealth & Development Office (FCDO), and Sida (Swedish International Development Cooperation Agency)
Fund size	Currently cUS$40m loan book. (Since 2001 it has funded $53.4m loans and $22.5m grants across 170 projects.)
Investment instruments	Secured loans, which can be amortising (repaid regularly over the life of the loan) or bullet (repaid in full at the end of the life of the loan), depending on the context of the project. A small portion of funding is via grants (in recent years, less than 5%).
Investment size	Based upon Reall's risk certification of an organisation: up to £500k for a 'basic' organisation, up to £3m for an 'intermediate' organisation, and up to £15m for an 'advanced' organisation. The largest single investment made to date is £5m.
Investment terms	C6-7% interest rate (well below commercial loans in the target geographies), three- to five-year terms, secured against land and property.

Key Points

1. Transformation from grant funding to catalytic capital investment over the last decade. Historically, Reall provided grant funding to civil society organisations for affordable homes projects, n an attempt to help these organisations become more commercial, but this proved challenging. Over the last decade or so, Reall has transitioned to providing investment in the form of loans (grants are less than 5% of the funding mix now) to private sector social enterprises to build and sell climate-smart, affordable homes (average construction cost of US$14,250 per home in the last five years). The transition to largely repayable finance allows Reall to recycle capital and fund further projects to maximise the impact of its catalytic capital.

2. Stringent operating and investment processes ensure the efficient allocation of scarce catalytic capital. Reall identifies partner organisations via a due diligence process (including fraud, financial and anti-terrorism checks). Organisations that pass due diligence are certified as basic, intermediate or advanced, given their track record and other attributes. Once an organisation becomes a certified partner, it can then apply for funding. Reall has stringent criteria for approving investments – projects must be sustainable, commercially viable and meet stringent non-financial criteria to ensure the creation of high-quality, resilient and affordable housing stock. All houses must be EDGE Certified,[35] accompanied by essential services (energy, water, flushing toilets etc), and have tenure and land title deeds passed over once loans are repaid.

Implementing partners operate a pre-sales model, where they collect data on clients before a project is completed, to help assess a buyer's likely behaviour once they have acquired their property. Partners include clauses in sales contracts that ensure properties remain part of affordable housing stock. Anecdotally, home buyers tend to be of a view that it had been such a struggle to get the home and it is so precious to them, that they are unwilling to sell.

In 2018, Reall introduced an eight-step assurance framework – an important part of which is monitoring projects and investments. Reall undertakes annual assurance visits, which look at the quality of homes as well as assessing the financial management of the investees. Of its existing c$40m loan book, approximately half are bad debt provisions of 5% or less, while the other half are problematic and may be converted to grants. All problematic projects pre-date the introduction of Reall's eight-step assurance framework. Problematic loans are managed by a specific department at Reall, which helps to transition the loan towards an exit. When an investee has been acting in good faith, a plan is developed to find an exit, demonstrating the flexibility of the capital that has been provided. Assets can be liquidated, land developed, or alternate contractors can be brought in to finish projects.

3. Investments are highly risk-tolerant, flexible and concessionary.

- While loans are secured against specific land and assets, they are highly risk-tolerant – Reall operates in countries where the risk premium is higher. It has lawyers and teams in each country within which it operates, to liaise with central banks and ensure local legislation is followed, helping ensure funds can be recycled or repatriated. Reall lends in local currency, thereby taking exchange rate risk when any loan repayments are repatriated.
- Funding is very concessional, with interest rates of c6-7%, as compared to local commercial funding rates of above 10%, e.g. Nigeria c16%, Ghana c22%.
- Reall's investments are flexible, especially with circumstances outside the control of the investee. For example, Reall has converted loans to grants where there has been very significant depreciation of local currency. Reall has a credit control department that works with organisations to help them meet their repayment schedules, and to provide necessary adjustments, such as pausing interest repayments during Covid-19. Flexibility is offered only to those partners that have acted in good faith.

4. Outcomes – Reall is proving a model for affordable homes that can be replicated. Reall has built c5,000 homes in the last four years (with over 25k people housed), is creating a model which can be replicated, and is helping strengthen local markets to deliver high-quality affordable housing at scale:

Reall's track record has proved to local banks that mortgages for quality, climate-smart affordable housing are viable. Reall has even partnered with banks to ensure those purchasing affordable housing from Reall investees have access to affordable financing. This not only improves the commercial viability of a project (with a ready means for the homes to be sold once they are complete), but also develops the mortgage markets in operating countries.

Many of Reall's investees have been able to build on their track record with Reall financing, to attract further finance from development finance institutions and commercial loans.

Creation and structure

Reall was established in 1989 (originally called Homeless International) to help alleviate poverty in the emerging markets. In 2001, it launched its CLIFF programme, which unlocked low-income housing at scale through community-led infrastructure partnerships with governments and private developers, firstly in India and then across Africa and Asia. Reall has evolved to focus on a market-based approach, helping not only to build affordable, climate-smart homes via investment in a network of housing developers, but also to broker solutions that unlock markets (e.g. helping banks to develop mortgages for affordable homes).

Reall was funded with grants from the UK's FCDO, and that funding is permitted to be loaned to social purpose organisations for building affordable homes, and the capital that is returned can be recycled for further loans. Since December 2020, Sweden's Sida has provided grant funding to Reall, which can also be used for loans, and can also be recycled, but any recycled funds must be used for projects on the same conditions as the capital was originally loaned.

Case Study Fourteen - International case study

Buen Vivir Fund – collaboration and flat power structures in the deployment of catalytic capital

The Buen Vivir Fund's mission	The Buen Vivir Fund aims to support the needs and aspirations of grassroots groups led by Indigenous Peoples, youth and women that are building the next economy, while at the same time enhancing climate resilience.
Why is the funding catalytic capital?	Investment decisions are made by a Members Assembly, comprising equally investees and investors, focused on funding community projects to maximise impact. Funding is a mix of grant and loans (concessionary). Loan capital must be repaid, but there is no interest payable (instead investees self-determine a pre-agreed 'aporte' payment, to be made if their project is successful). Terms are flexible – investees acting in good faith that cannot make repayments have their payment terms restructured or the loan written off.
Year established	2018 (following inception of the idea in 2016)
Impact focus	Indigenous Peoples, youth and women in Latin America, North America, Southern Africa and South Asia, with a focus on driving impact for all.
Investing entity type	Fund
Source(s) of capital	Eight US-based foundations each committing at least US$12,500 grant capital and $125k investment capital.
Fund size	$1m
Investment instruments	Loans and grants (average mix of 21% grant and 79% loans)
Investment size	$60k average across first nine investment projects.
Investment terms	Loan capital is repaid but 0% interest is required. Instead of interest, investees self-determine an 'aporte' payment to be made if their project succeeds.

Key Points

1. The fund has a collaborative, participatory governance structure with equal roles for investors and investees, which helps to promote the efficient deployment of catalytic capital. The first market gap that the fund was set up to address was the lack of participation of the beneficiaries of impact investment. Thousand Currents, an international NGO based in the US, set up the fund in a way that challenges typical investing power dynamics and economic norms. The fund is governed by a Members Assembly, rather than a board of directors, with investors and partners taking equal roles in decision-making. The Members Assembly comprises ten grassroots partners, eight institutional investors (principally foundations) and one representative from Thousand Currents. Some of the features of the fund's governance and operating model are:

- The fund had two criteria for organisations to be part of the Members Assembly – those whose current work included a focus on alternative economic or financing practices, and those with existing relationships to Thousand Currents or strongly recommended by trusted contacts. Of the ten grass-roots organisations, nine were established Thousand Currents partners.
- The fund invests in grassroots partners, which in turn invest in community-led processes for social change and 'good living' (buen vivir). For example, EduPaz is one of the fund's ten grassroots partner organisations. The Buen Vivir Fund has invested in EduPaz's UMA Fund, and the UMA Fund in turn uses loan capital to finance rural producers to create small enterprises (eg coffee and chicken co-operative businesses).
- Investment applications are reviewed by three to five peers from the Members Assembly. The first step in the investment due diligence process is to evaluate whether the proposed investment is coming from a real community organisation with the will of the community behind it, and that will help the community to become more self-determining and achieve autonomy.
- The Members Assembly prefers all decisions (relating to investment and investment terms, conflict resolution, strategy and membership) to be by consensus of all members. If consensus cannot be reached, decisions are made by majority vote with each member having one vote. Given the make-up of membership, investees in aggregate have a majority.

2. Investment terms exemplify catalytic capital. The second market gap that the fund sought to address, was that despite the increasing diversity of investees, the terms upon which they received social investment were similar. Investments of the fund have the following features:

- Patient, flexible and concessionary – all investments receive a combination of initial grant, investment (to date, all investment has been debt), and multi-year grants that help to support ongoing operating costs of projects.
- Terms are highly concessionary and risk-tolerant, requiring a return of capital but no return on capital (ie 0% interest), so that investors shoulder more of the financial risk. Instead of fixed interest being paid, investees pay a voluntary 'aporte' payment. This is a pre-agreed amount which the investee has determined should be paid upon successful completion of their project. The amount varies by project, but is typically 2-15%. The purpose of the solidarity payment is to benefit future investees and the communities they serve, by passing any growth achieved forward, increasing the available capital for future investment.
- Legal enforceability of investment agreements ensures capital is flexible. Agreements are not designed to be enforced in courts, and instead specify that disputes are resolved by the Members Assembly. If, for example, an investee fails to repay, under its guiding principles, the Members Assembly will determine whether the investee has acted in good faith with conditions outside the investee's control. If the investee has acted in good faith, either repayments will be restructed, or the loan will be written off entirely.

Creation and structure

The Buen Vivir Fund was established in 2018, having been co-designed by Thousand Currents together with donors, grassroots partner organisations and advisers. It was designed to provide a long-term resource for grassroots groups worldwide to create economic initiatives that challenge the economic norms of impact investing, and prioritise buen vivir. 'Buen vivir' is a way of living that is in balance with the natural world, community and generations of the past, present and future.

Outcomes

The fund is currently invested in grassroots groups in Mexico, Guatemala, South Africa, Nepal and India. Its nine projects have been in areas as diverse as housing, healthcare, environmental and climate protection, and small business development for artisans and farmers. Projects collaborate with local communities, and many focus on restoring or preserving Indigenous sovereignty as well as women's rights and leadership. The aportes mechanism with the idea of passing growth on to the next project allows for continued recycling of catalytic capital, while the Members Assembly and governance mechanisms ensure this scarce capital creates the greatest impact possible, with its focus on holistic benefits to communities.

Case Study Fifteen - International case study

Impact-Linked Fund for Gender Inclusive Fintech – Impact-Linked Finance at work

Impact-Linked Fund for Gender Inclusive Fintech's mission	The Impact-Linked Fund for Gender Inclusive Fintech (ILF for GIF) aims to improve financial inclusion for women in Sub-Saharan Africa, Asia, Middle East and North Africa. The fund supports women-led fintechs and gender-inclusive fintechs, increasing cost-effective access to financial services for women. Financial inclusion has been shown to increase female empowerment, decrease extreme poverty and have a positive effect on education, healthcare and nutrition.
Why is the funding catalytic capital?	Financial incentives linked to achieving social outcomes are paid directly to fintechs or embedded in investment terms (lower interest cost), effectively lowering the cost of finance. Investments are risk-tolerant, targeting marginalised women with new or early-stage financial technology products and services. Social outcomes are designed on a case-by-case basis, and in collaboration with the investee.
Year established	2022
Investing entity type	Fund
Source(s) of capital	Swiss Agency for Development and Cooperation (SDC), Austrian Development Agency
Fund size	US$13.4m at first close in March 2022 (target fund size $21m)
Investment instruments	Social impact incentives (SIINC), impact-linked loans, impact-linked convertible loans, impact-linked revenue share agreements, impact-ready matching funds
Investment size	$500k to $5m per transaction
Investment terms	Financial incentives of up to $200k to $1m per investment are provided to investees who have achieved predetermined social impact targets. Incentive payments may be paid directly to the investee or embedded in investment terms (e.g. interest rate reduces according to how much impact is achieved, and potentially results in a negative interest, meaning less than 100% of capital needs to be repaid).

Key Points

1. Tailored approach to catalytic capital – the ILF for GIF provides highly targeted catalytic capital, with financial incentives paid to investees achieving pre-determined social impact targets. The fund is managed by Roots of Impact (a specialised advisory firm pioneering impact-linked finance) and iGravity (advisory and investment management firm). It aims to improve financial inclusion for women in developing economies by growing women-led and gender-inclusive fintechs (such fintechs have been shown to more consistently target female customers). In turn, financial inclusion has been shown to increase female empowerment, decrease extreme poverty and have a positive effect on education, healthcare and nutrition. The ILF for GIF achieved its first close of US$13.4m in March 2022:

- The ILF for GIF provides financial incentives to investees, while crowding in private sector investment through impact-orientated investment manager partners (including Bamboo Capital and Women's World Banking Asset Management). Partners will invest $500k to $5m per deal in women-led and gender-inclusive fintechs. The ILF for GIF then provides targeted financial incentives of $200k to $1m per investment, which 1) incentivise fintechs to tailor their solutions to the needs of marginalised women, and 2) for fintechs already focusing on gender, boost their revenues and profitability, helping to attract additional investment to scale and increase their impact. These incentives ensure capital is provided that is concessionary (payments increase revenue, or interest costs are reduced), and allow investees to focus on less-developed products and services (ie risk-tolerant).
- Capital is flexible – the impact incentive structure is bespoke and designed in partnership with the investee to reflect their context, and in doing so, maximises impact additionality and aligns incentives. Target outcomes could include improved financial literacy and stronger financial health of female clients, vulnerable women served as a proportion of total client base, and livelihood improvements for female clients.
- An independent verifier ensures that all impact data collected and consolidated is correct. Incentive payments may be made directly to the fintech or embedded into investment terms. Initially incentives will be in the form of premium payments or social impact incentives (SIINC) made directly to fintechs. After the initial phase of the fund, incentives will also be embedded into investment terms (e.g. interest rate reduces depending on the scale of outcomes achieved), including impact-linked loans, impact-linked convertible loans, impact-linked revenue share agreements and impact-ready matching funds.

2. ILF for GIF is aiming for $100m of blended finance being made available to investees. In the long term, the ILF for GIF aims to become a fully-fledged blended finance fund. For this fund, philanthropic funders will provide capital in two ways: 1) non-repayable grants to fund outcomes; and 2) a dedicated first-loss funding tranche. The combination of the two is expected to attract funding from the private sector and development finance institutions and allow for increased deployment of catalytic capital.

Creation and structure

The ILF for GIF secured $13.4m in a first close in March 2022 from the SDC and the Austrian Development Agency. The fund is expected to reach $21m at the final close. As a first-of-its-kind fund, it will share its research and learnings to provide a blueprint for other gender-smart financing solutions and impact-linked finance structures. It will work with ecosystem enablers including incubators/accelerators, venture builders and intermediaries, that are specifically focused on marginalised women (e.g. Women's World Banking and Village Capital).

The ILF for GIF will invest in investment-ready, early- to growth-stage fintechs that meet at least one of the 2X Challenge Criteria (e.g. 51% or more women ownership), with high (additional) impact potential and a corresponding growth plan. Fintechs must be willing and able to measure impact metrics (with support). Special focus will be given to fintechs with the ability to serve vulnerable women, such as migrants.
In addition to providing investment funding, technical assistance funding is being made available to fintechs and ecosystem enablers to help with impact measurement and management (with measured impact to be independently verified before financial incentives are paid out to investees).

Outcomes

Gender-inclusive fintechs accounted for just c1% of total fintech capital raised in 2019, according to the Center for Financial Inclusion. Since it began to be measured in 2011, the gender gap for financial inclusion has remained constant in developing economies (whereas it has narrowed in developed economies). Many fintechs tend to focus on targeting early tech adopters, largely perceived to be men, unintentionally ignoring the needs and preferences of female clients. The ILF for GIF is targeting the closure of this gender gap, by accelerating cost-effective and convenient access to financial services for women.