Scottish National Investment Bank (SNIB) and its role in supporting Scotland's social enterprises.

About:

Scottish Community Re: Investment Trust (SCRT) was established by Social Enterprise Network Scotland (Senscot) to ensure that social enterprises had access to appropriate and relevant social investment products; training; support and information. It is the culmination of 15 years work by Senscot to build the infrastructure required to support a vibrant and sustainable social enterprise economy in Scotland. This includes seeding Scotland UnLtd; Firstport; Social Enterprise Academy; Senscot Legal; DTAS and P4P.

SCF Ltd is the financial arm of the SCRT. Established in October 2017 as a Community Benefit Society and registered with the FCA (7649), it operates as a Community Development Finance Institution (CDFI) with the aim of supporting both geographical and thematic communities to raise affordable, patient capital to undertake socio-economic activities that are mutually beneficial to everyone living and working in those communities. It operates by issuing Community Bonds directly to local 'citizen' investors.

Most micro and social enterprises, particularly those within disadvantaged communities, struggle to find financial products suitable to their operations and to allow them to develop further. By 2018 bank lending to Micro & SMEs had still not reached its pre 2008 level (House of Commons Treasury Committee Oct 2018 report). This is certainly the case for social enterprises and community businesses who work in communities where there is market failure.

Research carried out in Scotland found that these community and social enterprises struggle to find investment that is appropriate to their needs – affordable; micro; unsecured; patient and risk capital (Scottish Community Re: Investment Trust 2014). Other bodies undertaking similar social investment research in the intervening years have subsequently supported these research findings.

Why Social Enterprises fit with SNIB purpose:

Social enterprises should be of significance to SNIB for four reasons: their scale and reach within the Scottish economy; their extensive linkages with both private and public entities at the local level; their unique 'output mix' – embracing not just economic but social and health outcomes – and finally their role in fostering the inclusivity agenda and building social capital.

There are currently 17 local social enterprise networks (SENs) across Scotland, stretching from the Scottish Borders to the Highlands. Additionally, there are 7 thematic networks – Food; Culture and Creative; Employability; Health; Sport; Tourism and finally Rural.

Collectively these networks represent 1,400 social enterprises in Scotland - 27% of the 5,200 recognised social enterprises. They are well embedded into Scotland's communities via their networks of intermediary organisations such as Scottish Community Alliance; Community Land Scotland; Community Recycling Network Scotland; Community Energy Scotland Community Transport Association (Scotland); Development Trusts Association Scotland; Scottish Communities Climate Action Network etc.

Most, if not all, of these social enterprises adopt the 'Voluntary Code of practice for social enterprises operating in Scotland'. Unfortunately, social enterprises exist in era where the trust and reputation of charities across the UK is at an all-time low as a result of a variety of damaging high profile cases. Against this background, the 'Code' is increasingly seen as a way of assuaging the concerns of the general public by offering transparent and measurable criteria that they can use to assess the behaviour and performance of these social enterprises and hold them to account.

In addition, the five criteria that the Code embodies – Values Based; Good Employers; Democracy; Empowerment; Collaboration – collectively form the basis of meaningful inclusive growth strategies.

Social Enterprises Networks as socio-economic infrastructure:

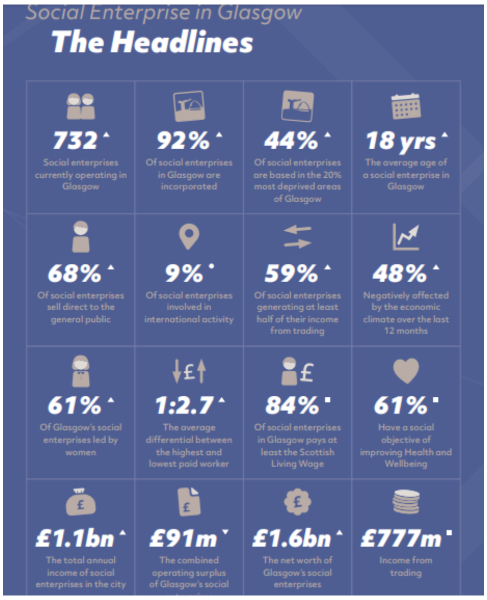
Where these social enterprise networks exist, they form important, but shadow socio-economic infrastructures that are as essential to the long term sustainability of communities as the local Chambers of Commerce members. Collectively, they employ 12,000 people and have a combined turnover of £0.5billion and operate across a broad range of sectors including environmental; tourism; travel; culture; regeneration; employability amongst others.

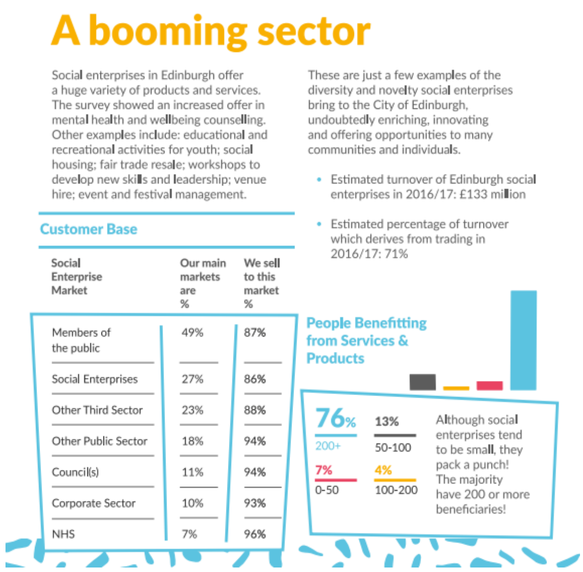
These social enterprises tend to emerge organically responding to the need for particular goods and services within different communities across Scotland. Alternatively, they can emerge from opportunities that arise within communities.

Some of them own significant capital assets, whilst others provide crucial services such as, employment, social care, health and well living opportunities.

The economic and social community infrastructure that SENs create also link significantly to local, private and public sector actors. They also significantly enhance social capital reach as measured and proven by the report (U>P Unlocking More than Potential).

The collective impact of some of these networks have been researched and measured producing impact reports that have evidence the benefits to the local economy and local people including contributing to local community wealth building and retaining income locally. (see examples from Glasgow & Edinburgh below).





A booming sector

Social enterprises in Edinburgh offer a huge variety of products and services. The survey showed an increased offer in mental health and wellbeing counselling. Other examples include: educational and recreational activities for youth; social housing; fair trade resale; workshops to develop new skills and leadership; venue hire; event and festival management.

These are just a few examples of the diversity and novelty social enterprises bring to the City of Edinburgh, undoubtedly enriching, innovating and offering opportunities to many communities and individuals.

- Estimated turnover of Edinburgh social enterprises in 2016/17: £133 million
- Estimated percentage of turnover which derives from trading in 2016/17: 71%

Customer Base

Social Enterprise Market	Our main markets are %	We sell to this market %
Members of the public	49%	87%
Social Enterprises	27%	86%
Other Third Sector	23%	88%
Other Public Sector	18%	94%
Council(s)	11%	94%
Corporate Sector	10%	93%
NHS	7%	96%

People Benefitting from Services & Products

76% 200+
13% 50-100
7% 0-50
4% 100-200

Although social enterprises tend to be small, they pack a punch! The majority have 200 or more beneficiaries!

Social Enterprises Financial Issues:

Social enterprises suffer from the same problems in accessing suitable development capital as equivalent micro, SME private firm but perhaps even more so. There are a range of factors (outlined below), that have resulted in a lack of social finance provision for these social enterprises. This has impacted significantly on their ability to develop their services and impact.

a) The concept of 'growth' is too narrowly defined only in terms of geographic expansion, either regionally, nationally or internationally. It doesn't appear to recognise that 'deepening' the impact of community based social enterprises is just as important. By deepening, it is meant that the reach of the social enterprises is moving beyond the low lying fruit to the harder to reach, harder to address issues within communities. Equally, it doesn't appear to take cognisance of the increasing Scottish Government approach to a post growth or wellbeing economy.

b) The micro nature of these social enterprises is seen as unattractive to social investors and in particular their perceptions of risk. Yet 94% of all Scottish businesses (340,000) are micro sized employing under 10 staff. Within that profile, the size of social enterprises are typical. Where they differ in relation to risk is that the private sector micro/SME financial default rate is 10.5%, whereas for social enterprises that default rate is less at 6.1% (Responsible Finance, 2018)

c) The lack of available security is clearly an issue for social investment providers. The asset lock and the lack of equity models can prevent the giving of financial security. Even those social enterprises owning capital assets, will typically have secured these via a grant, which can prohibit these social enterprises from offering them as security. This can increase the risk profile of these social enterprises which make them unattractive to invest in, although they are typical of this section of the social enterprises.

d) Code compliancy is seen by social investment providers as a hinderance at best and at worse an obstacle. Rather disappointingly, these providers have shown little interest in developing and creating Code compliant financial products that would meet their needs. Instead what is available are mere variations of mainstream financial products built upon mainstream legal structures and mainstream concepts of scale and equity. What is required are more bespoke products that are suited to them.

e) Social enterprises are more difficult to assess than conventional firms because they often have complex – and unusual - revenue streams that are contingent on public sector decision-making including legislative outcomes. This raises the transactions cost associated with appraisal and the perception of risk.

Unfortunately, what appears to be emerging is another form of market failure, ironically in the very service that was created to assist social enterprises - appropriate social investment provision.

<u>Illustrative Examples of Joint Actions between SNIB and social enterprises:</u>

The impact and scope of community based social enterprises to address environmental and social issues within our communities is well documented. Operating within Code specific criteria and an OSCR regulatory landscape, they do not fit easily into the mainstream financial ideal. The appetite of social investors to look beyond the norms existing within mainstream financial services is low, often for very obvious and understandable reasons. However, what cannot be allowed to happen is market failure in the very marketplace that was established to financially assist these social enterprises.

The SNIB could prevent such a situation from arising and could amplify the potential of these social enterprises. Outlined below are just four ways in which SNIB could act.

1. SNIB could adopt an approach that recognises the importance of these local socio-economic infrastructures and ensure they can continue to develop. SNIB could contract with SCF Ltd with creating ‘neighbourhood loan funds’ ringfenced specifically for social enterprises in each area. This is particularly important as research (‘Contract Readiness Fund Report’ Oct 2015 Ecorys) indicates that direct reach and knowledge of how they work is vital to their successful uptake of financial resources.

SCF Ltd/SCRT, via its links to, and knowledge of, these community based social enterprises, could provide assessments of embryonic business ideas and plans more effectively than SNIB. Utilising the 'intelligence' within the existing SEN infrastructure to avoid uneconomic 'transaction costs' and de-risk loan decisions.

2. When engaging with lenders SNIB could, as part of its due diligence or ESG processes, incorporate or take a lead on encouraging lenders to consider how their supply chains and subcontracting arrangements could benefit social and community enterprises. This exercise would also ensure that SNIB meets its strategic objective of generating inclusive growth impacts locally.

3. Recent Land Reform legislation has extended community right to buy into urban areas. However, the Scottish Land Fund is financially limited in the extent to which it can support community acquisition in urban areas. SNIB could match the existing grant pot to introduce blended financial products that would reduce the cost of money in addition to de-risking it. Utilising the existing SEN infrastructure and its experience and expertise on the ground would ensure that this push happened more quickly and in a more orchestrated and sustainable manner.

4. Scotland has one of the most enviable social enterprise infrastructures in the world. Rather disappointingly, the social investment substructure is still very limited with a few big players producing a very narrow range of products. SNIB could support and work with existing social investment providers, like SCF Ltd, to create 'Code' compliant products that would be appropriate for social enterprises.

5. SNIB could support the SCF Ltd ambition to make Scotland a nation of 'Citizen Investors' that the Community Bonds and Community Shares infrastructure seeks to create. Citizen Investors are ordinary people investing directly and collectively in their communities. SNIB could underwrite their issues; match any funding raised by these debt instruments; provide 1 year 'bridging' financial that gives communities retrospective time to raise money via Bonds or Shares to purchase assets like sports clubs or buildings.