



# **The Role of Private Equity in Social and Sustainable Development**

March 2008

## CONTENTS

<b>Executive Summary</b> .....	<b>3</b>
<b>Introduction</b> .....	<b>6</b>
<b>1. Private Equity &amp; Corporate Responsibility</b> .....	<b>10</b>
1.1. The Rise of Corporate Responsibility.....	10
1.2. Issues and Drivers for the Private Equity Industry .....	12
<b>2. Mainstream Private Equity</b> .....	<b>15</b>
2.1. Introduction: CSR and Philanthropy in Private Equity.....	15
2.2. Drivers of Corporate Social Responsibility.....	15
2.3. Modes of Engagement .....	18
2.4. CSR Roadmap .....	19
<b>3. Specialist Private Equity</b> .....	<b>22</b>
3.1. Building New Markets.....	22
3.2. Cleantech and Renewable Energy.....	23
3.3. Future Specialist Markets.....	27
<b>4. Social Investment</b> .....	<b>31</b>
4.1. The Social Investment Space .....	31
4.2. Funding Models.....	35
4.3. The Role of Private Equity in Developing a Social Investment Infrastructure.....	37
<b>5. High Engagement &amp; Venture Philanthropy</b> .....	<b>39</b>
5.1. The Evolution of Philanthropy .....	39
5.2. The Role of Venture Philanthropy .....	40
5.3. The Development of Venture Philanthropy in Europe.....	40
5.4. The Venture Philanthropy Landscape.....	41
5.5. Social Impact and Benchmarking.....	43
5.6. Private Equity Involvement.....	43
<b>Case Studies</b> .....	<b>50</b>
<b>Appendices</b> .....	<b>69</b>
1. United Nations – The Principles of Responsible Investment.....	70
2. Equator Principles .....	72
3. Education .....	75
4. Establishing a Philanthropy Programme.....	77
5. Companies Act – Responsibilities to Stakeholders .....	80
6. Online Survey Results.....	81
7. Methodology.....	85

## **EXECUTIVE SUMMARY**

### **BACKGROUND**

*CSR, social investment and philanthropy are becoming increasingly relevant topics for mainstream venture capital and private equity houses. There is considerable interest within the private equity community in deepening engagement with the issues, reflecting:*

**1. Environmental and social issues moving up the agenda**

87% of private equity respondents feel that their organisations' involvement in the area of environmental sustainability will increase over the next 3-5 years, while 60% feel that social and philanthropic ventures will become of increasing relevance over the same period.

**2. Increasing focus on governance and transparency**

The growth of the private equity industry has broadened its sphere of influence and increased the range of stakeholders, with an associated change in expectations of the industry. This has also been reflected in the recent publication of the Walker report.

**3. A need to understand the broader impact of corporate activity**

As key agents of economic growth and change, there is an appreciation that corporate activity can have negative social and environmental externalities, and that engagement with CSR, social investment and philanthropy can help address these issues.

**4. Movement towards social innovation and entrepreneurialism**

A range of individuals and organisations have recently encouraged more use of entrepreneurial solutions to social problems, which has a strong resonance with the private equity model. Simultaneously, there has been an emerging recognition of the growing economic importance of the social sectors which are set to be significant future areas of economic activity.

*However, CSR, social investment and philanthropy cover a broad range of complex areas, with the key features and issues including:*

**1. The cultural divide**

The cultural divide between the social and business worlds, in terms of language, approach and motivations, tends to be cited as a barrier to greater engagement. Third sector organisations may be wary of the 'financial community' and sensitive to the potential for compromising their mission. The different pace and the culture of the third sector can prove frustrating for business professionals, as can the complexity of some social problems.

**2. The emergence of future markets**

Many areas emerging in relation to CSR, social enterprise and charity go on to become important in mainstream business. Cleantech, for example, has moved from the non-profit margins to the mainstream with the involvement of venture capital / private equity investors together with intermediary firms and specialist advisors.

**3. Funding and skills gaps**

New funding organisations, financial instruments and models of engagement are emerging in the social sector. The process of developing a funding ecosystem is one which the venture capital and private equity industry has itself been through, and therefore has potentially valuable experience to help accelerate the similar processes within the social sphere.

The private equity community already has considerable involvement in philanthropic activities. However there is growing interest in new ways of engaging that reflect private equity's strengths. This is bringing with it a cultural shift, including a greater desire to apply business models to philanthropy. A cluster of new developments are taking place in the space between purely commercial activity and traditional philanthropy, including new social venture funds, social investment banks, and venture philanthropy. Although there remains a cultural divide between charity and mainstream finance, this is beginning to blur. The entrance of mainstream venture capital / private equity investors together with intermediary firms and specialist advisors has been an important part of this process in areas like cleantech and could soon be replicated in other fields. However, the engagement of the industry remains at a very early stage, limited in terms of scale and depth. Many firms are unsure how best to contribute; and there is a marked lack of the brokering skills and intermediaries needed to maximise impact.

## **NEXT STEPS**

There are a number opportunities for private equity firms to look beyond the mainstream to make a significant social and environmental impact. In this report we set out a range of potential areas of activity for venture capital and private equity, as they move beyond small-scale traditional philanthropy to better use their distinctive skills. A wide range of niches are likely to be filled over the next few years, with specialist and generalist social venture and investment funds seeking different levels of return, and experimenting with the balance between social and commercial returns. We anticipate a maturing series of markets and exchanges – helping to link individuals and firms to opportunities, courses and events providing rapid means of gaining understanding of the social field and how to achieve impact - as well as research and academic institutions becoming centres of expertise. All of these provide great opportunities for particular venture capital and private equity houses to make their own mark.

There is a strong desire within the third sector to tap into the experience, skills and resources of the venture capital and private equity industry. This is alongside the continued evolution of the sector itself where an ecosystem of participants from investors to specialist advisors needs to be developed and there are many questions still to be resolved. In particular there tends to be a funding gap for organisations which have the potential to scale, with the funding of core organisational operations (as opposed to funding to directly address the social need targeted by the organisation) being a specific issue. The sector is also one in which the government plays an important on-going role, and where there is a process of market-proving required to bring key areas towards the mainstream. Simultaneously, many private equity firms, which are focal points for many relevant skills for third sector organisations, are looking to deepen their involvement with social and environmental issues.

## KEY RECOMMENDATIONS

### **1. There is a need and desire for greater collaboration between private equity and the third sector. In order to facilitate this collaboration, an annual BVCA-sponsored forum should be created to enable the two communities to meet and integrate.**

This forum would provide an opportunity not only for networking and firm-to-firm connections to be built, but also to work through some of the technical and operational issues in the third sector, where private equity firms have specific expertise to share.

This can be very specific to supporting new approaches to social innovation and investment:

- Ways of incentivising social entrepreneurs through deal structuring
- Identification or creation and promotion of social impact/return benchmarks

As well as help build engagement and develop the sector as a whole:

- Ways of engendering a philanthropic culture within firms
- Exploring tax incentives for investment in social ventures and funds
- Initiatives to address negative social consequences arising from commercial activity

### **2. Support the formation of the Social Investment Bank to act as a wholesaler for new funds, including new funds focused on specific problems or sectors, to support social ventures at a variety of organisational growth stages.**

In order to promote the development of the nascent third sector markets and investment currently emerging, there is a need for greater intermediation and formal channels into the mainstream capital markets. The creation of a Social Investment Bank with funds from dormant accounts would be an important milestone in that process, helping to attract in other organisations to build a funding ecosystem and network of advisors to support the growth of social ventures at a variety of organisational growth stages.

### **3. The BVCA can embed social engagement in its own work, building conduits between the mainstream finance community and the social investment sector. Practical steps include:**

- Creating a 'social member' category with investor profiles in the BVCA directory
- Including a social investment unit within the foundation course
- Enabling access to BVCA training programmes from the social sector
- Establishing joint initiatives with other active organisations (e.g. EVPA; IfP<sup>1</sup>).

### **4. Private equity firms should approach social engagement with the same rigour and intensity as their core business, setting specific objectives and working with intermediaries with knowledge and networks in the social sector.**

Firms and individuals from the private equity industry already have considerable involvement in philanthropic activities and there is appetite for new and creative ways of engaging:

- Setting specific targets for engagement of money, time, and network (or a combination) on social issues (e.g. 1% of pre-tax profits / time).
- Supporting or partnering with early-stage specialist social funds to engage with and build networks in emerging sectors (such as health and criminal justice), adding commercial expertise and experience to achieve greater impact.
- Encouraging staff participation – e.g. providing meaningful chunks of time between deals – can be highly rewarding in terms of personal and professional development.
- Tapping into the deep expertise and networks that already exist within the third sector through intermediaries as a more effective way of addressing issues.
- Create a voluntary code to address the growing impact of environmental sustainability on business enabling the private equity industry to take a lead in creating workable and practical principles

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<sup>1</sup> European Venture Philanthropy Association; Institute for Philanthropy

## **Introduction**

By The Young Foundation

This report aims to highlight the opportunities and possible steps the private equity industry, firms and individuals could take to become more engaged in the societal and environmental issues around them. We highlight the changes and growing insights impacting society and why social issues, such as ageing and growing care needs, are becoming more prominent. The emerging field of social investment is then highlighted which offers a new, and largely unfilled space to apply private equity methods in unique ways.

The private equity industry has gone through a far-reaching transition over the past twenty to thirty years. Once thought of as insurgent outsiders to the financial community, private equity practitioners today are very much part of the mainstream, with much greater power, visibility and expectations of accountability. Some firms and individuals in the private equity industry are already actively involved in social issues. There is also extensive personal giving, corporate social responsibility and other kinds of support for social sector organisations. Overall, however, the relative scale of this activity is seen to be modest. There is limited data to illustrate whether the industry is pulling its weight and overall activity in the field is not widely publicised or appreciated. As a result we found a very low level of knowledge within the industry as to what others were doing.

The last few years have, nevertheless, brought some very promising new developments. Permira's engagement with CAN, the setting up of the Private Equity Foundation and the Young Foundation's new social venture funds are all examples of this. But compared to the active social engagement and substantial financial commitments of some of the top business leaders in the US such as Bill Gates, Warren Buffett, Jeff Skoll and Pierre Omidyar, the attentions of the most successful entrepreneurs and financiers in the UK remain relatively unseen and limited. The industry has much to contribute both in terms of finance and expertise but there seems to be a reluctance to redirect the unique strengths and skills of the private equity industry towards helping to tackle social issues.

Mainstream business has steadily become more engaged in social issues over the last 20-30 years under the banner of CSR. Whilst some CSR activities are purely cosmetic, others have involved significant investment of time and resources, and some have supported important innovations that went on to achieve major impacts. Many private equity and venture capital companies already engage in some CSR, and the greater power and visibility of the sector is likely to raise the incentives for the industry to invest in social issues, both for reputational reasons and for other reasons, including motivating staff. At various times, leading businesses have suggested a target of 1% of pre-tax profits for commitment to social causes, and although only a minority have reached this target it provides a possible benchmark for the private equity industry. This scale of resources, and a healthy competition between venture capital and private equity houses to demonstrate their skill, could have a significant impact, particularly in the cutting-edge fields that are less likely to be supported by traditional philanthropists and foundations.

### **Why: motivations and drivers of change**

But why should anyone in the industry be interested in social issues? Why not simply concentrate on the core business and leave others to worry about social impacts? We identify ten sets of motivations and drivers for change which are present in varying degrees across the industry:

First, personal motivations will always be an important factor. Current levels of giving are significantly lower in the UK than the US (0.7% of GDP compared to 1.67%). Giving by the very wealthy is even lower in relative terms,<sup>2</sup> which Sir Ronald Cohen once blamed on the fact that many City people, 'do not today realise early enough the need to put something back

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<sup>2</sup> International Comparisons of Charitable Giving, CAF, 2006

if the system is to operate smoothly'.<sup>3</sup> Yet many leaders, and many employees, have very strong personal motivations to make a difference and give something back, and many want to be engaged through their work as well as out of it.

Second, staff motivation and development. Because of these personal motivations there are strong pressures for leading companies to demonstrate that they offer opportunities to individuals to get involved in social initiatives as well as commercial success. This has been a key driver in US business where social engagement has become a marker not only of commercial strength but also of seriousness of purpose. It has also become a key field for staff development – building up judgement, resilience and social skills.

Third, new market opportunities and deal availability. Wider trends are pulling venture capital and private equity into sectors which are more politicised, and visible to public opinion. This is true not just of essential infrastructures and PFIs but also in sectors like health and care.

Fourth, public and consumer perceptions. Investors are increasingly attracted to companies that act with good corporate governance and social responsibility, and so avoid the major risks of regulatory, public relations and reputational damage. Consumer attitudes to issues such as ethical products (fair-trade, organic) or sustainability are playing a powerful role, and evidence suggests a steady trend towards consumers applying choice criteria beyond the traditional value-for-money ones.

Fifth, private wealth. Clients with substantial private wealth are looking to businesses which can simultaneously provide them with high returns and high social impact. With an estimated US\$40 trillion being passed from one generation to the next over the next 50 years just in the US alone<sup>4</sup>, there is also intensifying competition to provide a more rounded set of offerings to the very wealthy.

Sixth, shareholder value. A wide range of factors influence shareholder value and result in pressures from portfolio companies which may adopt higher standards than the investing firm itself. This potentially affects the market value and ability to exit a portfolio company.

Seventh, the potential impacts of a slowdown. If there is a global slowdown this will undoubtedly intensify the spotlight put on the industry, with greater attention to how it responds to closures and job losses. This will, in turn, require attention in terms of helping people find new skills and jobs.

Eighth, sector regulation. There is greater openness and transparency in the private equity industry. The BVCA's initiative in setting up a working party under the chairmanship of Sir David Walker, to consider issues of transparency and disclosure, is a clear indication of this. More precisely, section 5b of the November 2007 paper 'Guidelines for Disclosure and Transparency in Private Equity' calls for more information about environmental matters (including the impact of the company's business on the environment) as well as social and community issues. It will be of benefit to any private equity firm to be on top of these issues at an early stage.<sup>5</sup>

Ninth, the London factor. London has become markedly more unequal over the last two decades (London now includes some of the UK's areas of highest unemployment as well as its highest earners). During a period of healthy growth these inequalities have not led to dramatically higher crime rates or increased social breakdown. However, experiences in France, and in past decades in the US and UK, show how quickly social issues can explode, and how damaging this can be for business.

Tenth, market foresight. All industries need to understand not only their current environment but where it might be heading. Over the last decade environmental issues have moved from

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<sup>3</sup> Interviewed by David Rowan, Jewish Chronicle, 22 September 2007.

<sup>4</sup> 'Innovations in Philanthropy', Lecture given by Ms Jackie Khor of the Rockefeller Foundation presented by the Lien Foundation Centre for Social Innovation, 3<sup>rd</sup> January 2008 at SMU Singapore.

<sup>5</sup> 'Guidelines For Disclosure And Transparency In Private Equity', Walker Working Group, November 2007, Section 5B, Pg. 26

the margins of the investment industry, where once they were associated with the fringe of activists and a few scientists, to being firmly part of the mainstream. This emergence is highlighted by the rapid growth of new industries (like renewables), new markets (like carbon) and new regulatory pressures on businesses. A similar shift may be occurring around social issues. Whilst previously seen as of relatively marginal importance to business, let alone to investors, the biggest industries of the 21<sup>st</sup> century economy are already social industries. Health and education in the UK stand at £120bn<sup>6</sup> and £70bn<sup>7</sup> respectively, already significantly larger than the car, steel or computing industries. The prospect of ageing, combined with growing demand for care and learning (including growing demand for support for long-term conditions and chronic diseases), means that these are set to become even more important over the next few decades. To date these areas have been largely the domain of the public sector, but they are opening up to the private sector as user expectations continue to rise and government seeks to open up these markets to other providers, competition and innovation. There are already examples of private equity interest which should continue in future years as they become more mainstream.

### **What can be done?**

If these are some of the motivations for engagement, what form should that engagement take? Currently much of the industry's activity is very traditional philanthropy – giving sums of money to deserving charities, primarily in traditional and uncontroversial fields (particularly children). Yet the most important and distinctive potential contribution of the industry is to use some of its methods to accelerate the development of new and more effective business models in the social field. This field is full of creativity and innovation but tends to be poorer at translating ideas into viable models, whether for the public, private or non-profit sectors. This is particularly important during a period of far-reaching change in the social field – with a revolution underway in both eldercare and childcare, as well as a steady flow of new knowledge about everything from cutting crime to preparing teenagers for the labour market.

The first priority is to address the most important needs, and not simply to follow fashion. It was very important in the 1980s that some funders were willing to engage with HIV/AIDS, just as in the 1990s it was very important that some were willing to support refugees and undocumented migrants. The Young Foundation is currently working with a dozen foundations to map the most acute contemporary needs, looking at issues as varied as elder abuse and the position of children having to care for disabled parents. In some cases, the priority is simply to help people out; but in many fields new models of provision and support are also needed.

Michael Young, one of the world's most well known and successful social entrepreneurs commented that a benign ruthlessness was needed to build successful social innovation, and he focused much of his energy on designing new, scalable models to meet social needs. Many of these, from distance learning and extended schools to phone based health diagnoses, have grown to a very large scale.

### **New social venture funds**

To find these new models, energetic and systematic innovation is needed. This is where the industry could be contributing far more, by mobilising its abilities to model markets and needs (and to analyse risk), its creativity in financial engineering, as well as its understanding of growth patterns and how to drive efficiencies. Some of these skills are already being used, primarily to help existing mainstream charities and social enterprises to grow. But we believe a bigger contribution could come in supporting more radical innovation, in fields such as eldercare, mental health, the rehabilitation of offenders and community cohesion. In many of these fields the inadequacy of current models loads very heavy costs onto the state, as well as onto society. New models of service provision, as well as new models of finance, are badly needed. We therefore see a major need for specialist venture funds to help design and develop the promising new models in these fields. Venture capital and private equity firms

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<sup>6</sup> 2006 figures; source: Office of Health Economics

<sup>7</sup> 2004 figures; source: Oxford Economic Forecasting Database, Education at a Glance



can act as cornerstone investors for funds of this kind, working alongside the players in this field such as NESTA, and providing funding initially on a philanthropic basis but increasingly developing more commercial and quasi-commercial models with a mix of social and financial returns.

### **Investing time**

Alongside finance, relatively low staff turnover should allow firms to free up small amounts of time between deals for staff to become involved in shaping emerging social ventures. This type of engagement is an excellent way to refresh people, as well as providing them with insights into new industries, growth trends and emerging needs. For example a “Director bank” approach to matching executives to social sector organisations could have real value.

With the development of new models for delivering social impact, charities are no longer the only way to become socially engaged. Venturing approaches more in line with private equity experience are emerging in the fields of social enterprise. Launchpad, for example, is an early stage social venture fund which is part of the Young Foundation, setting up new charities, social enterprises as well as for-profit ventures with social objectives. An example project is the School of Everything, which is being developed as a commercial company but with a distinctively social purpose to change the way people learn by providing an online marketplace for learning. The company has raised investment from a combination of corporate and experienced angel investors. But projects of this kind would value further executive and non-executive engagement in their early stages so that they can marry social impact and business acumen rather than seeing these as opposites.

### **Intermediaries and Engagement**

To make the most of the industry’s potential, new kinds of intermediary are needed. Intermediaries that have appeared in recent years range from organisations that provide guidance and signposting, such as New Philanthropy Capital and the Institute of Philanthropy, to philanthropic approaches primarily targeting charities, such as Impetus, Breakthrough and the Private Equity Foundation. In addition, social investment approaches such as mezzanine providers, like Venturesome, or providers of finance to social enterprises, such as BigInvest, have emerged alongside models focused heavily on providing support as opposed to funding, such as Pilotlight or Cranfield Trust.

However, the sector can do more to explore models focussed on social venturing, enterprise and engagement where closer ties between private equity and venture capital could provide valuable skills and expertise. The use of financial instruments such as equity, quasi-equity, debt, or convertible grants are fairly new to the social sector. Other practices which are mainstream in the industry are also being used more often, including active engagement with investees through executive coaching, support with financial and business analysis, as well as active portfolio management, including use of clear performance metrics and providing access to privileged networks.

Some of the funds entering this space provide a social screen but also aim to achieve a financial return for their investors, such as Bridges Community Ventures. Others explicitly ‘trade off’ some financial return in order to achieve social returns. Many of the funds in this space attempt simply to make their funding stretch as far as possible by recycling some of their funds and are supported on an entirely philanthropic basis. Venture philanthropy funds avoid the difficulties of mixing social and financial returns by restricting themselves to giving their money away primarily in the form of grants but they still apply some of the non-financial practices of private equity.

In short, this is an underdeveloped field but one that is seeing a great deal of energetic innovation. For an industry that is under pressure to demonstrate its broader responsibility, there are now many opportunities to show leadership and set up or support funds sharply focused on the most important needs. With the economic climate changing, however, the industry needs to move swiftly or risk being seen too often only as the problem, rather than as part of the solution.

# 1 Private Equity & Corporate Responsibility

## Section 1.1

### The Rise of Corporate Responsibility

Issues of social, environmental and corporate sustainability have been steadily rising up the agenda in recent times. Within the private equity community, 86% of people surveyed<sup>8</sup> believe that their organisations' engagement with issues of environmental sustainability will increase over the next 3-5 years, while 60% indicate that social and philanthropic ventures will become of increasing relevance to their organisations over the same timeframe.

The increasing significance of these issues to private equity is unsurprising given the broader picture. Within the corporate world, the areas of Corporate Social Responsibility (CSR), and Environmental, Social and Governance (ESG) have shifted firmly onto the strategic agenda, having been historically perceived as little more than 'window dressing'. Today, these areas are becoming of real commercial significance.

Simultaneously the philanthropic landscape has evolved. The wealth of 75% of the UK's richest individuals has shifted over the last 15 years from being predominantly inherited, to being predominantly self made<sup>9</sup>. This societal shift has been supported by the rapid growth of the UK financial services industry over the past decade, and the rise of private equity and venture capital as an increasingly significant part of this. The UK's entrepreneurialism has created a culture where innovation is seen not only as a means of generating wealth, but of changing society.

Likewise, the political landscape continues to evolve, with the development of a new social contract which is both altering expectations of who provides what social services and is presenting new opportunities for non-public sector organisations. In key areas of welfare provision, such as health and education, new solutions are being sought that draw on involvement from the public sector, private sector and the third sector – charities, NGOs, and social initiatives.

For the private equity community, recent times arguably represent a 'coming of age'. Having grown over the last 30 years from being a nascent, regional and alternative model of business funding, ownership and support, the industry now supports organisations at every stage of their lifecycle, from the earliest stages of their development to being a critical element in the financial structures of some of the largest global businesses.

Overall, private equity now has considerable mass and reach in terms of the number of people directly involved, the breadth of its broader stakeholder base, and the amount of capital under management. As a result: more and more private individuals have heard of private equity; the livelihoods of many people are partly reliant on the industry either as the owner of their employer or as the manager of part of their pension fund's assets; and political and media interest in the industry is at an all-time high.

Private equity houses fundamentally play the role of agents of change, both directly within the corporate world, and indirectly (through the actions of portfolio companies and returns generated for investors) in broader society. The shifting nature of corporate responsibility, stakeholder perceptions and the social contract therefore presents the venture capital and private equity community with a challenge in terms of its role and ways in which it addresses its impact, intended or otherwise, on society and the environment. The opportunity is therefore to be a leader, rather than a follower, engaging in the shaping of society and future commercial markets, rather than being responsive to the changes that are already taking place.

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<sup>8</sup> Source: Online survey, 2007 conducted for this report (see Methodology note, Appendix 7)

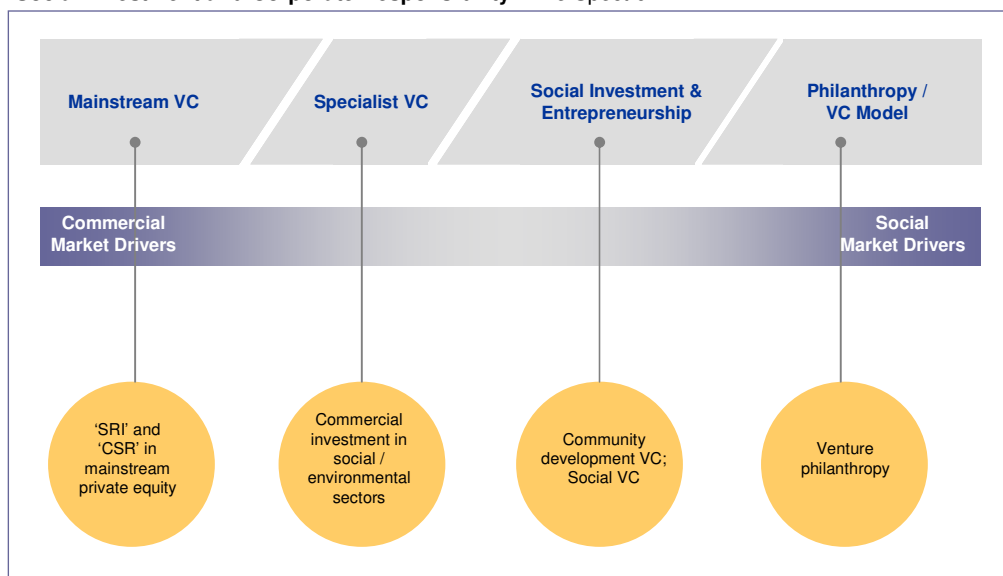
<sup>9</sup> Source: Sunday Times Rich List / Philanthropy UK, reported in FT.com 14/12/07

## About this report

This report aims to provide those active in the mainstream venture capital and private equity community with a map of organisations active within key social and environmental areas and examples of the ways in which private equity houses are already engaging with a broad spectrum of CSR and third sector initiatives. It also seeks to seed ideas for ways in which firms can extend and deepen their activities to become more effective.

For the purposes of this report, key organisations have been subdivided on the basis of their approach and key drivers to form a spectrum (see Figure 1).

Figure 1  
Social Investment and Corporate Responsibility - The Spectrum



At one end of the spectrum are mainstream private equity houses, which are addressing issues of CSR and Environmental & Social Governance (ESG) from a number of perspectives, including investment selection and due diligence through portfolio management and value add, as well as looking for ways to become more engaged as an investor or corporate philanthropist in socially-driven initiatives and charities.

Next are specialist venture capital houses which are targeting commercial investments in specific sectors which have grown into more mainstream markets but have roots in issues of social, ethical or environmental relevance – for example, climate change and cleantech.

The next segment of the spectrum encompasses a range of organisations tackling social issues with a range of engaged support and innovative funding models. A variety of commercial and social outcomes are sought by investors in this part of the spectrum, though the majority tend to focus on creating strong organisations that maximise their ability to be self-sustaining, are able to go to scale, and have a developed understanding of the nature of their impact and seek to maximise it.

At the other end of the spectrum are organisations using a pure venture philanthropy model, supporting charitable organisations with grant funding, but looking for new ways to apply entrepreneurial disciplines to understand and maximise the potential impact, and helping organisations go to scale.

Sixty-one individuals from 57 organisations across the spectrum contributed to the research for this report, quotes from whom are included within this report. This includes representatives from private equity houses already actively engaging with social and environmental issues, as well as the third sector organisations directly tackling those issues and finding solutions.

## **Key Issues in the social space**

CSR, social investment and philanthropy encompass a broad range of complex challenges and opportunities, which many organisations are grappling with through their activities within different parts of the spectrum outlined above. The specific issues of relevance vary through the spectrum, but there are a number of common themes relating to commercial and social organisational cultures, the development of future markets, and funding and skills gaps.

### ***The cultural divide***

The mainstream venture capital and private equity community and the social enterprise and charitable sector have developed largely independently, and while an entrepreneurial culture has emerged in both, they often remain separated by different languages that reflect their different motivations and aims. Consequently, different organisational forms and work practices are relevant in each area, different modes of funding are applied, and different notions and measure of success and impact are considered.

The cultural differences are often the biggest barrier to greater engagement between those in each camp. Part of the aim of this report, therefore, is to highlight the need for further conduits between the two communities and to flag up those organisations already active which can help mediate the relationship between the commercial and social arenas.

### ***The emergence of future markets***

The evolution of private equity over the last 30 years is a classic example of the emergence and acceptance of a market once on the fringes of the finance community and now at its very heart. Across the spectrum (outlined above) are other examples of organisations actively engaged at various stages in similar processes of market building. While the cleantech and renewables sector provides an example of one such market which has moved over the last 5-10 years from being left field to almost mainstream, other more nascent markets also exist within the social investment arena.

A key theme in this report is therefore the process of market making, the value of organisations that are already engaged in this process, and the role of mainstream investors in accelerating it further still.

### ***Funding and skills gaps***

The process of market building also has particular links to addressing gaps. The mainstream private equity market now has a highly developed funding ecosystem, which includes venture, growth capital, and buyout funding supported by a range of intermediary organisations on both the deal and fundraising sides. In the social sphere, 'markets' are far more nascent, but are actively being identified and tested.

The experience of the venture capital and private equity industry is potentially valuable, therefore, in terms of both providing a model for what is required to drive a market into the mainstream, as well as being able to help directly address some of the funding and skills gaps that currently exist.

## Section 1.2

### **Issues and Drivers for the Private Equity Industry**

As has already been suggested, the rise of entrepreneurialism has not been restricted to people's business lives, with individuals looking to apply some of the same rigour and vigour they have for their core businesses to other parts of their lives. The private equity and venture capital communities have themselves, being entrepreneurially-motivated, produced many such people.

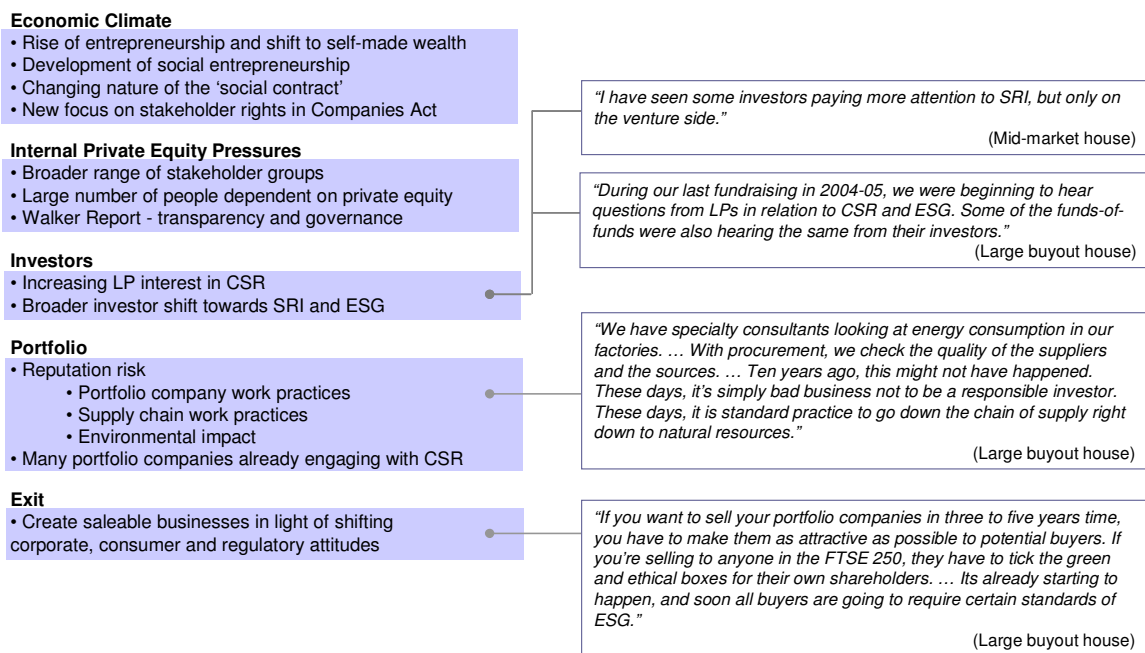
There are, for example, many venture capital and private equity executives who regularly give generously on a charitable basis. There are also individuals heading up private equity firms who are introducing CSR-based initiatives into core business practice at the level of both the private equity house itself and portfolio companies. Likewise, there are a number of

individuals with particular interests in terms of supporting social, ethical or environmental causes, who have developed charitable or philanthropic initiatives associated with their firms to address such issues. There are also a number of individuals, such as Stephen Dawson and Sir Ronald Cohen, who have been active outside the private equity firms they are, or were, involved with either through founding or working with organisations that support social investment and charitable initiatives.

At the current time, much of the industry's engagement with these issues, and especially those of a philanthropic nature, has fallen below the radar. This, in part, reflects the fact that the majority of, particularly charitable or philanthropic, activity is undertaken by individual executives on a private basis. By the same token, it is also a reflection of the fact that many of the issues associated with social and environmental impact have not, until more recently, been relevant at the 'corporate level' within private equity firms.

However, as has already been noted, there are a number of broad changes going on within society and business such that the majority of individuals within the private equity industry now expect these issues to be more relevant to their firms in the coming years. Consequently, for a variety of operational and economic reasons, issues of CSR and a deepening engagement with the social investment sector at a corporate level are becoming increasingly relevant to all private equity houses (see Figure 2).

Figure 2  
Drivers of CSR - Issues for Private Equity Houses



Firstly, issues surrounding corporate governance and transparency recently coalesced in the form of the Walker report and its associated recommendations, which raises the advantages of being a leader, rather than a follower in these areas, to avoid being the subject of mandatory compliance imposed from above.

*"Essentially it is about addressing the potential downside in terms of reputation risk."*  
Large Buyout House

Secondly, the research highlights an increased interest amongst institutional investors in issues relating to social and environmentally responsible investing. Given the degree of overlap between general partners' investor bases, it seems likely interest will rapidly propagate through the industry. Separately, recently quoted figures from the US also suggest that \$1 of every \$9 under professional management in the US now involves an element of

'socially responsible investment'<sup>10</sup>, highlighting the growing significance within the broader financial community.

Thirdly, advances across the corporate landscape in CSR strategy have also served to raise the profile of social and environmental responsibility amongst business leaders. At a portfolio level, many corporates are already responding to consumer and regulatory pressures with regards to CSR and issues such as sustainability and community engagement. In particular areas, the regulatory framework that has been initially applied to the largest organisations (e.g. in relation to carbon emissions) is on course to be shifted to encompass a broader range of sectors, which will in turn have a cascade effect, impacting smaller businesses (and in some cases the individual). Likewise, in terms of ongoing company operations, recent high profile instances, such as the problems Gap had with some of its supply chain subcontractors, highlight the reputational risk which can occur as a result of failing to apply the necessary diligence to ensuring ethical business practices.

While social responsibility and environmental issues may rapidly become of significance in operational terms for portfolio businesses, they are already high on the agenda of larger corporates, which represent both potential vendors and acquirers to private equity. In terms of achieving an effective and successful trade sale, being advanced in these areas may currently be a differentiator, but may rapidly become a necessity.

This report therefore considers the ways in which issues of CSR, social investment and philanthropy are already being addressed by mainstream private equity and venture capital houses, and the opportunities to broaden and deepen this engagement to make it more effective. In addition to a particular focus on mainstream organisations, this report also considers the range of initiatives being undertaken to support third sector organisations, and the ways in which the private equity community could more effectively contribute.

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<sup>10</sup> Geoffrey Heal (Columbia Business School) quoted in Franklin, D (2008) 'Just Good Business' (The Economist) 19.1.08 Special Report p.3

## 2 Mainstream Private Equity

### Recommendations

1. Increasingly, corporate social responsibility is of strategic and operational significance for all businesses. For private equity firms, CSR has relevance at both the organisation and portfolio level. Leading the process therefore mitigates against being subjected to mandatory guidelines as CSR becomes standard business practice.
2. Tackling CSR should be a staged process, focussing initially on getting one's own house in order then focussing on the portfolio – both in terms of due diligence and post-investment risk management and value creation
3. There is an opportunity for the industry to consider its own voluntary code addressing the environmental and social impact of its activities. This will enable the private equity industry to take a lead in creating a workable and practical set of principles

### Section 2.1

#### Introduction: CSR and Philanthropy in Private Equity

As highlighted earlier, respondents from across the venture capital and private equity spectrum believe that issues of environmental sustainability and engagement with social investment and philanthropy will be increasingly important to their organisations over the next 3-5 years. These changing attitudes reflect a shift towards a deeper corporate engagement with issues of economic, social and environmental impact.

In the corporate sector, engagement with CSR has become increasingly relevant over recent years both from the perspective of avoiding the pitfalls of not being involved and reaping the benefit of being more overtly engaged. Here, CSR arguably has three layers<sup>11</sup>:

- Corporate philanthropy: a business will for example, give around 1% of pre-tax profits to charitable causes (we will deal with this area separately in chapter 5)
- Risk mitigation: adopting a CSR strategy to minimise the risk of involvement in practices that will cause reputation damage and impair long-term performance
- Value creation: increasingly, CSR strategies are being seen as having commercial value in terms of creating operational efficiencies, competitive positioning and consumer attraction

For both the broader corporate world and private equity, a particular distinction can be drawn between initiatives relating to the ongoing operation of a business in terms of CSR and those with a philanthropic motivation which go beyond the core business (*see Chapter 5*).

### Section 2.2

#### Drivers of Corporate Social Responsibility

There are a range of factors serving to put CSR on the agenda of private equity houses from operational, economic, and reputational perspectives. Within the broader corporate world, CSR issues have been moving up the agenda. A recent Economic Intelligence Unit survey<sup>12</sup> of global executives showed that three years ago around a third of respondents considered CSR to be of 'high' or 'very high' importance. Today the figure stands at over a half, with it predicted to rise to around 70% in three years time.

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<sup>11</sup> Source: Franklin, D (2008) 'Just Good Business' (The Economist) 19.1.08 Special Report p.3

<sup>12</sup> Quoted in Franklin, D (2008) 'Just Good Business' (The Economist) 19.1.08 Special Report p.3

Recent changes to the Companies Act (*see Appendix 5*) also reflects this shift, with company directors now required to consider the environmental and social impact of their business on a broader stakeholder base, beyond their immediate shareholders.

Across the corporate world, businesses are increasingly addressing CSR in response to pressures such as reputation risk, industry scandals, external NGOs, the climate change debate, employees and investors. Indeed, the impact of longer term changes to the environment, society and the economy on businesses is likely to ultimately affect performance and the ability to generate returns. Consequently, some investment banks are taking a longer-term view, and helping establish the necessary infrastructure for including environmental, social and governance issues within equity research.

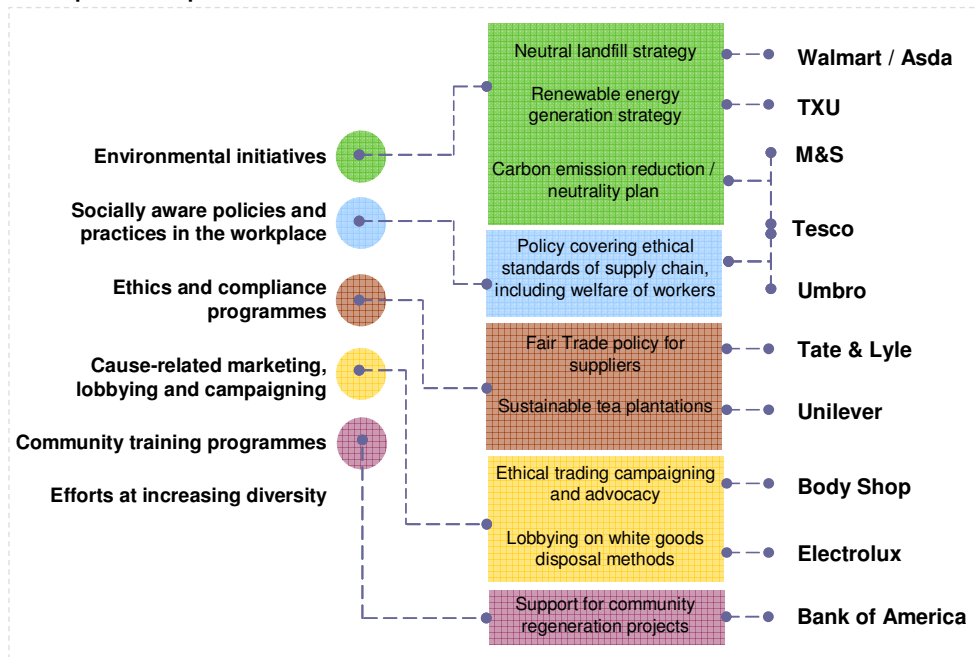
This ethos is exemplified by investment firm Generation Investment Management, which was created in 2004 by a team of six high-profile partners led by Al Gore and David Blood, ex-head of Goldman Sachs Asset Management. The team has developed a long-only equity investment strategy which looks beyond the short-termism of quarterly reports to analyse the influence of drivers such as changing demographics, population movements, climate change and changing public attitudes on corporate success: *'We focus on the economic, environmental, social, and governance risks and opportunities that can materially affect a company's ability to sustain profitability and deliver returns. Our research plays an important role in forming our views on the quality of the business, the quality of management, and valuation.'* The group only backs those companies that are actively addressing these areas, on the basis that they will significantly outperform their less progressive peers over the long-term.

Risk mitigation has played an important part in CSR's rise up the boardroom agenda, following high-profile and damaging scandals which have been experienced by a variety of diverse industries over recent years. The oil, gas and chemicals industries, for example, experienced fallout from disasters such as those involving the Exxon Valdez and BP's Texas Refinery. Likewise, the Big Pharma companies have seen backlashes over research methods and charging policy in the developing world with regard to key drugs such as those required by HIV/AIDS sufferers. In the textiles and consumer industries, a particular focus of attention has been on the work practices of suppliers, with other businesses such as Nike also having had to face accusations over the use of child labour. The experiences of Google being brought before the US Congress to explain its actions in relation to activities in China also serve to highlight the globalisation of CSR practice which is occurring.

As a result, corporates across the board have responded with a variety of CSR-derived strategies. For example, M&S and Tesco have gained a certain kudos by taking a proactive role in the environmental sustainability debate (*see Figure 3 for examples*).



Figure 3  
Examples of Corporate CSR Initiatives



Corporate Social Responsibility is not, however, a wholly new phenomenon. UK Steel Enterprise provides one example of an organisation effectively set up by a corporate in response to the particular issue of job losses resulting from restructuring of the steel industry. Steel manufacturer Corus has seen steel supply outstrip demand over many years, and has had to engage in ongoing rationalisation activities in order to remain competitive. To help address the loss of jobs and consequent community impact of this process, UK Steel Enterprise (see Figure 4) was established by the then British Steel in 1975 to support community regeneration through business initiatives.

Figure 4  
UK Steel Enterprise

UK Steel Enterprise aims to help improve the economies of those areas of the UK most affected by changes in the steel industry. It achieves this by creating a supportive environment for entrepreneurship amongst small business communities and thus encouraging job and wealth creation in the UK's steel areas. Since its establishment more than 30 years ago, it has provided finance, premises, help and advice to over 4,200 growth businesses. Having provided over £60million of total financial support, with over £50million in direct investment, UK Steel Enterprise has successfully helped create over 66,000 new jobs since its inception.

The rise of CSR up the private equity agenda is therefore perhaps unsurprising. The issues are already well established within the broader corporate community, and portfolio companies will already be dealing with them on a daily basis.

While our 'straw poll' results have shown a broad acceptance of the move towards greater social and environmental governance within private equity over the coming years, the current picture is more ad-hoc and fragmented. CSR tends to be viewed as ill-defined and encompassing everything from local volunteer work, through fair employment practice, to 'saving the planet'. In addition to this definitional problem, private equity firms are grappling with a number of perceived barriers in terms of tackling CSR including:

1. The complexity and breadth of issues that potentially fall under the CSR banner, including environmental issues, ethical employment and supply chain issues and the role of organisations in the community and wider society
2. The reconciliation of social and environmental responsibility with the reality of the private equity model, which often involves the implementation of cost reduction strategies to create long-term sustainability, which may have short-term consequences for labour markets
3. Sectoral variations across portfolios – the environmental impact of a fisheries business differs considerably from that of a discount retailer with global supply chains.
4. The lack of industry standards and accepted best practice in terms of due diligence pre-investment, and portfolio management post-investment
5. Resource constraints

## Section 2.3

### Modes of engagement

Given the range of issues that fall under the CSR banner, there is no one-size-fits-all solution. Indeed, those issues which are of particular concern in the UK, for example, are not necessarily as significant elsewhere, which has implications for owners of multi-national businesses. A recent McKinsey survey<sup>13</sup> highlights such regional variations on a global basis (see Figure 5). For instance, following the pensions crisis, issues surrounding retirement benefits became a much more pressing issue in the UK than on a global basis. Similarly, the threat of job losses from outsourcing is also ranked as more significant in the UK than globally, highlighting fears in certain UK regions in the face of the economic rise of overseas markets such as China and India.

Figure 5

#### CSR Issues: What will be most important over the next five years?

Issues ranked, 1 as most important

	Global	UK
The environment	1	1
Safer products	2	4
Retirement benefits	3	2
Healthcare products	4	5
Affordable products	5	3
Human rights standards	6	8
Workplace conditions	7	10
Job losses from outsourcing	8	6
Privacy and data security	9	7
Ethically produced products	10	9
Investment in developing countries	11	11
Ethical advertising and marketing	12	12
Political influence of companies	13	14
Executive pay	14	16
Other	15	13
Opposition to freer trade	16	15

Source: McKinsey Survey (September 2007), quoted in 'Going Global' (The Economist, 19.1.08, special report p.18)

On a sectoral basis the issues are also quite different, reflected by the range of high-profile events which have sparked CSR debate. Consequently, engagement with CSR issues is necessarily a stepped process of building on what is already being undertaken, engaging with external organisations to draw on their learnings and expertise, and understanding best practice to enable decisions to be made regarding whether to be a leader or a follower.

<sup>13</sup> Quoted in: Franklin, D (2008) 'Going Global' (The Economist) 19.1.08 Special Report p.18

Section 2.4  
**CSR Roadmap**

There are a number of stages in the process of engagement with CSR issues (see Figure 6) for private equity houses, including:

1. Private equity firm operations
2. Investment Selection / Due Diligence
3. Portfolio Management / Value Creation

Private equity houses are already actively engaging in CSR issues from a number of perspectives. Most recently, for example, this has included greater consideration of climate change related impacts and carbon emissions. Organisations like Carbon Trust and Forum for the Future work with corporates and financial institutions to help them address issues of sustainability. For instance, Doughty Hanson was certified carbon neutral early last year by The Carbon Neutral Company. In addition to this, the group’s latest annual investor meeting was also a carbon neutral event, with the travel arrangements of LPs over the two-days assessed and offset (see case study, page 51).

*“At the moment, we’re concentrating on implementing the easy stuff – becoming carbon neutral, integrating our venture capital companies with the rest of the business. For example, we have a film solar cell company whose products we’re integrating into our real estate development buildings. We’re actively changing the employment practices of our portfolio.”*

Doughty Hanson

Figure 6  
**Private Equity Approaches to CSR**

	Strategy	Description	Example	
<b>Organisation</b>	Ethical sourcing	Sourcing office supplies etc from ethical sources	Green Your Office Ltd	
	Employment practices	Ensuring outsourced staff treated fairly	Living Wage Campaign	
	Carbon neutral	Auditing; ebergy efficiency; carbon off-setting	Doughty Hanson; Apax	
	Social investment	Backing mission driven investment organisations	Apax, 3i, Doughty Hanson	
	Philanthropy	Building a corporate strategy, commitment to Private Equity Foundation	Various	
<b>Portfolio</b>	Transparency	Walker recommendations	Large buyout houses	<p><i>“We are keen to not just do the bare minimum in terms of Walker recommendations but to be a leader, and so are applying the Walker CSR guidelines across all portfolio companies (not only those in the UK).”</i></p> <p style="text-align: right;">Large Buyout House</p>
	Tracking portfolio economic impact	Highlighted by Walker Committee report	Being implemented by large buyout houses signed up to Walker recommendations	
	Tracking social and environmental impact	Dedicated 'sustainability' resource	Bridges balanced scorecard	
	Contribute to sustainability index	Dow Jones Sustainability Index	3i	
	Commitment to CSR at portfolio level	Business In The Community (BITC) CSR Index	3i	
<b>Investment Strategy</b>	Stated commitment to particular responsible investment principles	UN Principles	Doughty Hanson	<p><i>“Our Oil and Gas team is very engaged in terms of investment selection and portfolio management, health and safety and employee motivation. This is deeply engrained in our investment picking and portfolio management processes.”</i></p> <p style="text-align: right;">Mainstream Private Equity House</p>
	Identify or formulate ethical and environmental codes of conduct	Equator Principles	Banking community initiative	

3i has arguably one of the most evolved approaches to corporate social responsibility of any European private equity firm, partially reflecting its listed status, but also its roots in post-war community regeneration. The group has a dedicated Corporate Responsibility Committee, which considers and reviews environmental, ethical and social issues relevant to the business, reporting regularly to the board. This commitment to CSR extends beyond the 3i organisation to its 750-strong portfolio, with environmental, social and ethical matters considered during the investment decision-making process:

*"Our investment papers have a CSR section, where we check off whether there are any social, ethical or environmental issues with the company. Where there are issues, we undertake full due diligence to investigate them. These days, it is commercially imperative for a business to address issues relating to CSR. When it comes to exit, if a business has some horrible governance, environmental or ethical issues, then it can't be sold. It is in the commercial interest of the investment that these issues are addressed. CSR is simply good business practice."*

3i

To date, there has been a perception that many of the issues associated with CSR are of greatest relevance to the large buyout houses. However, those engaged with the policy debates around the emissions framework highlight both the likelihood of these issues cascading down to smaller organisations on the one hand, and the broadening range of sectors likely to fall under the spotlight on the other. For example, issues around transportation are moving up the emissions agenda, which has to date been most focused on energy generation and efficiency. As the agenda broadens, so therefore do the implications for private equity houses and their portfolio companies.

In terms of deal generation, environmental due diligence is now an established part of the deal process. However, the lens is shifting to take in a broader spread of ethical issues where there are fewer established modes of evaluation and monitoring. In this respect, one of the points raised in the Walker Report holds particular resonance, in that there is a developing debate about ethical business practices, and not engaging in this debate risks the imposition of a mandatory code of practice. The way in which environmental due diligence has become part of the standard due diligence toolkit also highlights the need for broad acceptance of the commercial significance of environmental and social impact, so those that do understand the need to address such issues are not at a competitive disadvantage by undertaking due diligence as part of a deal process.

*"A parallel example would be environmental due diligence. ... It has now become part of the mainstream, and even though it costs more and is time consuming, it's become part of the norm. In order to maintain a level playing field, it needs to become best practice. There needs to be a CSR due diligence template to remove the question of 'who will jump first?'"*

Mid Market Private Equity House

A number of standards and sets of investment principles are already available, such as those created by the United Nations (see *Appendix 1*), to which some private equity houses are signatories (see *Doughty Hanson case study, page 51*). Likewise, BitC (Business in the Community) provides a corporate responsibility index, which includes the likes of 3i (see *case study, page 52*).

Within the social investment space, progress is being made in terms of understanding social and environmental impact and relating it to business value and investment performance. Bridges Ventures' Balanced Scorecard approach provides an example of a framework for assessing and monitoring these impacts, yielding a triple bottom line assessment of performance for investors. This approach identifies the potential types of social and environmental impact an organisation makes, and how this relates to the value of the company, in five key areas (see *Figure 7*). The social and environmental impact of the portfolio is reported to investors alongside the commercial performance. This approach provides a framework with the potential for broader application to mainstream sectors in terms of understanding social and environmental risks at a portfolio company level and the impact this has on business and investment performance.

Figure 7  
Bridges Balanced Scorecard

**Social screen**

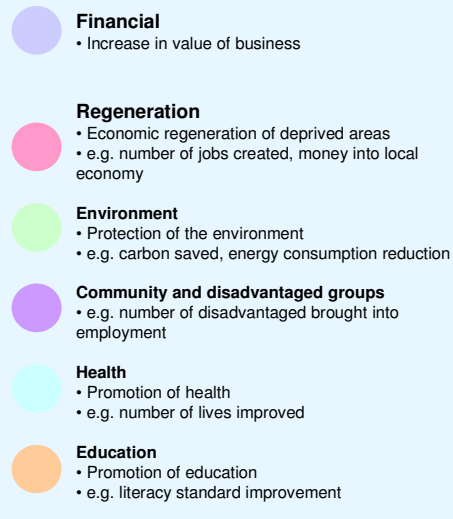
- Clear social impact criteria of location or sector set
- Commercial criteria used to select companies that pass the social screen

**Engagement**

- IMPACT scorecard used to focus on (1) community and environmental impact (2) commercial value of the business

**Reporting**

- Social impact as well as commercial performance forms formal reporting to investors



At an industry level, there are already examples of financial organisations themselves taking a lead in developing guidelines to address the potential environmental and social impact of investment activity. In the project finance field, the Equator Principles have gained widespread support from within the banking and finance industry.

The Equator Principles (*see Figure 8*) is a voluntary code for banks and financial organisations, committing those who sign up to using clear, responsible and consistent rules for environmental and social risk management in project finance lending.

Figure 8  
Equator Principles

The Equator Principles were announced in June 2003, and represented a significant industry-wide initiative in the area of social and sustainable investment. The initiative was spearheaded by international banking groups ABN AMRO, Citigroup, Barclays and WestLB, in collaboration with the World Bank's International Finance Corporation (IFC), on whose social and environmental standards the Principles were ultimately modelled. The banking industry had been grappling with the idea of creating a set of common social and environmental guidelines for some time and the Equator Principles enabled participating banks to establish themselves as leaders in sustainable investment, while short-circuiting the potentially lengthy process of establishing their own individual standards and diffusing the need to compete on environmental and social compliance.

An initial 10 banks committed to the Equator Principles, and four years on, there are a total of 56 signatories. The Equator Principles are widely considered to be the new market standard and credited with transforming the project finance industry. There are a whole range of reasons why banking and financial institutions adopt the Equator Principles, including a growing awareness of the risks associated with social and environmental issues, growing public pressure, the potential for reputational damage, shareholder expectations, as well as the motivation and retention of key staff.

*(See Appendix 2 for Equator Principles)*

## 3 Specialist Private Equity

### Recommendations

1. Acting in conjunction with existing organisations / intermediaries would add the weight of the private equity industry to key policy debates impacting the development of emerging specialist markets and help to ensure that regulatory outcomes are appropriate and workable.
2. Support or partner with early stage specialist social funds to engage with and build networks in emerging sectors, adding commercial expertise and experience to support new ventures in addressing social issues such as Eldercare, Mental health, NEETS, and Community Cohesion.

### Section 3.1

#### Building New Markets

For the purposes of this report, the 'specialist private equity' portion of the spectrum includes those venture capital and private equity houses which are adopting a purely commercial model, but are targeting investment opportunities in spaces that are perceived to be of social, ethical or environmental good. These markets are therefore characterised by the alignment of their social or environmental mission and their commercial success. There are a number of sectors which potentially fall within this definition, including cleantech, renewable energy, ethical consumer products and services and aspects of healthcare and education.

These sectors are differentiated from other areas of the third sector spectrum (discussed in other chapters) by their level of commercial development. Sectors being targeted by specialist private equity houses tend to be commercially proven, which provides the primary driver for mainstream investment, with the social or environmental benefit being a valuable, but secondary output. These factors are, however, a more significant driver during the market creation and development phase, with early pioneers often having mission-related motivations. This is in contrast to the model adopted by Bridges Ventures, for example, where the community development mission is the key motivation, but where a commercial strategy has been applied to realise this aim.

Aside from the common theme of social benefit which links the organisations targeting these sectors, they are also linked by their 'emerging market' status. Specialist private equity houses are actively engaged in sectors which have moved from being non-commercial or left field into the mainstream, with the engagement of mainstream financiers being a critical part of this process.

Emerging markets of this nature are of interest in the context of this report because:

1. They provide a model for how future mainstream markets could develop
2. They demonstrate how commercial models can be applied to social, ethical or environmental issues under some circumstances
3. They demonstrate the process of market building, which has relevance across other stages of the spectrum

Markets which are making this journey into the commercial sector tend to be initially characterised as immature, unproven, early stage, and often regulatory driven, without a fully-developed funding ecosystem (i.e. funding and skills gaps remain), and where government funding still plays a role. In the pioneering stages of market development, opportunities tend to fall below the radar in terms of mainstream awareness and engagement.

The particular drivers leading to the development of a market which is of interest to more mainstream venture capital and private equity models will vary depending on the specifics of that market. However, organisations in this part of our spectrum are all addressing markets

which have developed in response to social or environmental pressures. For example, climate change and the shift in the nature of UK welfare provision towards a more outsourced approach, to cite but two.

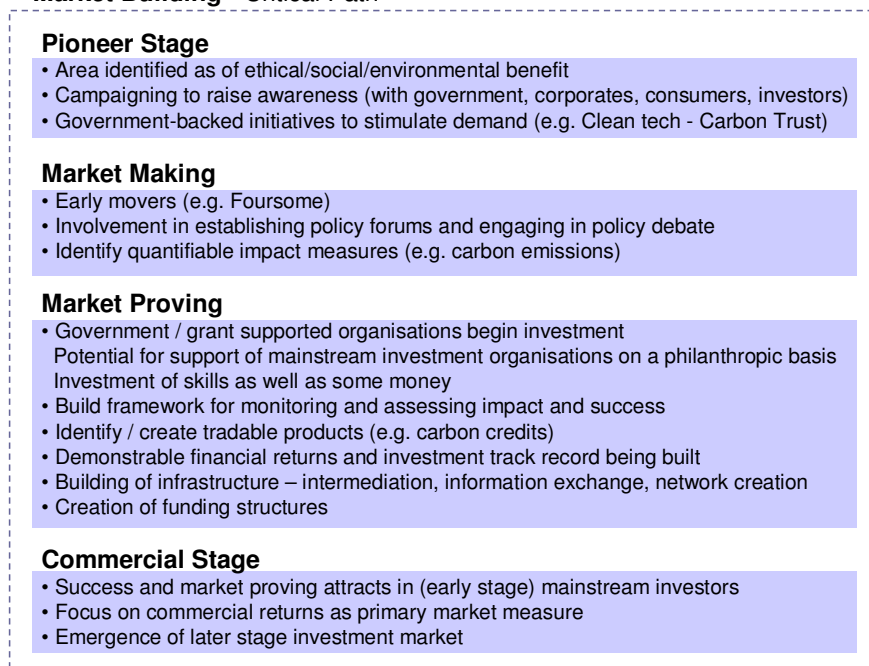
The cleantech and renewable energy market provides a particular case in point of a sector which has moved from, five to ten years ago, being a campaigning and research led space to one that is now within the broad remit of many mainstream generalist private equity investors. This sector is considered in greater depth in later sections.

### **The Market Building Process**

In order to achieve the move into the mainstream, a process of market building occurs. This includes engagement with the market-specific drivers and regulatory framework, as well as developing suitable organisational and funding structures for businesses, evolving the tradable commodities and markets in which they are traded. Proving the commercial case for a market, through the development of performance benchmarks, monitoring and measurement of returns, as well as the social or environmental and economic impact, is critical in providing a framework for attracting mainstream finance providers and intermediaries to create the mechanisms for market liquidity.

The market building process therefore has a critical path with a number of phases relating to the pioneer stage, establishing the potential for commercial activity and proving the market, and ultimately attracting mainstream investors and intermediaries (see Figure 9, below).

Figure 9  
**Market Building - Critical Path**



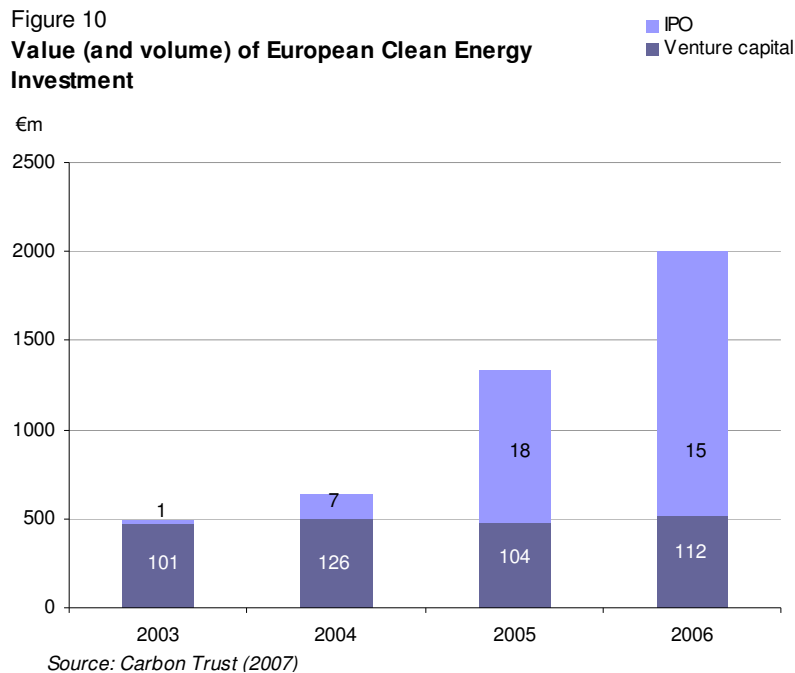
## Section 3.2

### **Cleantech and Renewable Energy**

Over the last decade, investment in cleantech and renewable energy has gained momentum and become an important feature of the financial landscape. While the specific nature of the transformation that the sector has been through is unique, the various stages highlight the process outlined above and the various types of engagement that are required to commercialise a market. The example outlined in this section is based on the cleantech and renewable energy sector; a range of other (associated) sectors have also grown up (such as

industries producing more energy efficient products), which have seen a different set of market conditions.

The growth of the cleantech and renewable energy sector in the mainstream finance arena is marked by both the consistent role venture capital has played in supporting the industry, and the significant growth in IPO activity over recent years, as illustrated by the following chart for the clean energy space (see Figure 10).



### Market drivers

The emergence of the cleantech and renewable energy sector has been driven by five key factors<sup>14</sup>:

1. The desire for energy security
2. Technological readiness
3. The emergence of new markets for clean energy
4. Environmental pressure (climate change)
5. The regulatory and fiscal framework

However, in order to commercialise this market, the sector has progressed through key market-building stages

Although the cleantech and renewable energy sector has now moved within reach of mainstream investors, it remains a sector where regulation is important in terms of its future direction (and therefore the success of different investment strategies). The process of campaigning and, more broadly, policy engagement therefore remains central.

For some active organisations, such as Carbon Trust and Climate Change Capital, engagement in the debates surrounding the regulatory framework is an important part of ensuring the sustainable commercial viability of the market. Such organisations have therefore been active participants in discussions around the post-Kyoto landscape, EU commitment to a 20% reduction in carbon and 20% of the energy mix to come from renewables by 2020, and so on. These issues have recently been driven further forward at the Bali Climate Change Conference.

<sup>14</sup> Based on : 'Investment Trends in Clean Energy 2003-2006' (Carbon Trust)



Given the role of regulation in determining the financial viability of parts of the market at this stage, engagement with the debates at a political level both provides a 'heads-up' on likely future developments, as well as being able to present the sustainable business case and help influence the future dynamics to ensure commercial sustainability. The role of regulation has been important in terms of creating markets for businesses within the environmental-sustainability sector in a number of areas. For example, landfill taxation has helped stimulate opportunities for recycling and efficient waste disposal technologies.

*"EU Directives such as the avoidance of contamination of ground water and the landfill tax have created good business opportunities, including the creation of technologies for burning waste, rather than burying it in landfill. This is not purely driven by the policy, but has its roots in economics. It is about saving money during the day-to-day operations of a firm."*

Specialist PE Firm

*"The market is entirely policy led; it provides an essential framework. The key top level drivers are the depletion of fossil fuels, and public demand for renewable energy sources. Government incentives provide the frameworks, which differ in each country, using tools such as taxes, tariffs and green certificates etc. The value of these subsidies reduces our costs sufficiently to be able to make a return."*

Specialist VC Firm

The nature of the cleantech and renewable energy space is such that there is an ongoing need for active lobbying in some areas. For example, a mainstream private equity investor looking at renewable energy investment opportunities on brown field sites highlighted planning bureaucracy as a particular stumbling block, and consequently a likely area of greater future lobbying engagement. To date, organisations such as UK Wind has been working on this issue from a lobbying perspective. However, given mainstream venture capital activity in this part of the market, there is a case for greater engagement at a lobbying and policy level for venture capital houses.

*"In terms of policy engagement, we do not do enough in this area currently, but are also looking to become more active. In particular ...the planning laws are very difficult, so there is a job to be done here to put pressure on to change legislation in this area."*

Mid-Market Private Equity House

In the US, the NVCA (National Venture Capital Association) has already taken on this role, having established a Cleantech Advisory Council, to identify key areas where policy engagement is required, and to formulate strategy accordingly (see Figure 11).

#### Figure 11 NVCA Cleantech Advisory Council

The National Venture Capital Association (NVCA), the US trade association for the venture capital industry, formed the Cleantech Advisory Council in 2006.

The aim of the initiative was to create a national working group that can identify regulatory and legislative issues critical to the development and commercialisation of new Cleantech technologies. The Council helps formulate NVCA's policy agenda in the Cleantech arena and is works to accelerate the growth of this emerging venture segment. The Council is open to NVCA Members who are actively investing in cleantech companies.

The need for input at a policy level is also of significance in terms of creating longer-term market stability. In a dynamic, developing market, the landscape is a shifting one. The recent Bali conference was a significant event for big business highlighting the requirement for policy clarity. However, on a more ongoing basis, taking an active roll in lobbying can help push this message to government, while also providing some visibility on likely future policy trends where evolution is still occurring.

*"The policy framework shouldn't keep changing – as an industry we need stability and long term visibility. There can't be changes every five years as this would be unworkable as a long term investor. ... If you're asking [investors] to back a changing and moving feast, then they can't get comfortable and they won't invest."*

Specialist VC

While the evolution of each environmental or social sector will reflect particular issues in each market, the process of market building in the cleantech and renewables sector has a number of features of relevance across the third sector. For example, the role of government (or another corner stone investor) as a pioneer risk taker is central in helping prove a market where one did not previously exist and mainstream models have yet to be developed. Likewise, the importance of regulation in many social and environmental areas means there is often a need for ongoing policy engagement. The role of intermediaries, such as investment banks, to facilitate market operation, whether that is the likes of Climate Change Capital in the environmental space, or the Social Investment Bank in social sectors, is also key to long term market sustainability. In all cases, engagement with (and by) mainstream players is also critical. Across the third sector, a variety of organisations are engaging with these same issues in particular areas, and are considered in the following chapters.

### ***Impact Assessment and Performance***

One of the perceived advantages climate change related markets have over social sectors is the measurable nature of carbon emissions. Across the social and environmental investment space as a whole, a recurrent theme in terms of enabling a 'market' to develop, is the ability to measure the impact.

In the climate change area, the ability to measure changes in carbon emissions has provided a single framework to link commercial objectives with environmental impact. Carbon credits, therefore, provide a commercially tradable surrogate for environmental impact. In turn, they have enabled carbon to emerge as a commodity with a market value that can be traded, and therefore provide a mechanism for investors to differentiate between investment opportunities and make more informed decisions.

*"The carbon reduction issue does have an advantage over some other social investment areas, in that it is a measurable commodity which has a monetary value."*

Specialist Private Equity Provider

In Europe, the impetus for the emergence of a carbon market has come through political engagement; thus, in the run up to the Bali conference, larger corporates were openly campaigning for further political clarity on the future nature of emissions legislation. By contrast, in North America, where there has been less political will to get involved in legislating in this area, corporates have themselves spear-headed the development of carbon as a tradable commodity and of a carbon exchange.

The development of impact measurement and benchmarking has been key to creating a market for carbon as a way of linking commercial and environmental goals. In the same way, issues of measurability and benchmarking are being addressed within other parts of the third sector in relation to providing a means for organisations to assess what makes the maximum impact, and to allocate resources accordingly. Work is therefore being undertaken by the likes of NEF and New Philanthropy Capital to develop means of assessment and to address the associated difficulties when dealing with the broad range of social issues. Unlike climate change, where carbon has emerged as a single framework for assessment, within the third sector a much broader range of issues and associated impacts are relevant, including in terms of areas such as crime prevention, healthcare improvement, community development, education and so on.

### ***The Funding Ecosystem***

Nascent markets often require kick-starting, and proving, before mainstream investors are prepared to enter. In many cases, therefore, the government has played an important role, effectively corner-stoning initiatives and taking the risk on pioneer ventures. A similar model has been seen elsewhere in the spectrum, for example in terms of the UK government's catalytic role in the first Bridges Ventures fund (*see case study, page 55*).

Likewise, in the cleantech space, government supported organisations such as Carbon Trust have played a role in promoting awareness and working with corporates to better understand the changing nature of the market and its requirements. Carbon Trust also provides equity to seed and early stage companies in the low carbon technology field, often co-investing alongside other venture capital funds, to address the gap at the very earliest stage of the funding spectrum. It has also partnered with academic and private sector organisations to support new ventures in this market, in particular 'The Imperial Low Carbon Seed Fund', which is a joint venture with the Shell Foundation and Imperial Innovations.

Alongside corporates and mainstream investors, intermediaries play an important role in the market-making process. In the case of clean technology, this has occurred in a number of ways. Organisations such as Climate Change Capital, in realising the need for intermediation, have positioned themselves in the investment bank mould to provide intermediary skills to external organisations alongside other functions such as policy engagement and investment. The role that CCC plays in the clean energy and renewables markets is not dissimilar to the role that a Social Investment Bank would play in the social sector.

As the market gains traction, it becomes self-generating. The larger the number of active players, the greater the interest in the sector, and the greater the dealflow. This includes also attracting the larger corporate finance houses into the sector.

*"All the mainstream generalists have someone nominally allocated to covering the cleantech area. ... At the venture end of the spectrum, having a large number of groups engaged in the space is a positive benefit in terms of generating deal flow. Our market works on a syndication, rather than a competitive, model. Most deals involve consortia of investors and the investment process tends to be more collaborative than competitive."*

Specialist VC House

The problem of intermediation is one of 'chicken and egg'. A thriving infrastructure of advisory and financial services firms is a vital ingredient of a mainstream capital market. However, in order to attract the advisory and support services firms, a market needs to be sufficiently proven to represent a fee-generating opportunity for those firms. Poor liquidity and market opacity impede the development of new markets, which is why pioneering organisations such as The Carbon Trust and Climate Change Capital in the environmental space, and the Social Investment Bank in the social investment space, are so important in creating a framework for market efficiency and transparency.

### Section 3.3

#### **Future Specialist Markets**

Cleantech and renewable energy provides an example of a sector which is now accepted within mainstream investment houses. However, there are other sectors which are going through a similar process of market making, but are currently at more nascent stages.

In the UK a process of change is in progress in terms of the provision of key public services. There is a broad shift in the nature of the social contract which is leading the public sector to open up aspects of service provision to organisations outside the public sector including third sector and private sector providers. This trend is set to continue and broaden to a range of areas over the coming years including healthcare, social care and criminal justice. Other areas such as microfinance and fair-trade, have also developed from third sector roots to become increasingly commercial.

*"There is a huge opportunity at the moment. The UK is doing something different, which other countries are likely to follow in that the government is paying people for things rather than doing it itself. There is the potential therefore for more stable revenue streams around the corner."*

Social Investment Organisation

These sectors have already started down the path of opening up to outside provision. We are seeing, for example, the devolution of control of budgets to individual beneficiaries, the separation of commissioning and providing roles, and improved commissioning and contracting practices in relations with the private and third sectors. While today much of the focus is on testing new approaches, the goal over time is to increase the provision of services to other providers. As these new specialist markets develop, the opportunity exists for private equity to start building networks and expertise in these areas. By engaging with intermediaries such as social investors or support organisations in specific areas such as health or criminal justice, a greater understanding of this market making in progress can be obtained alongside greater engagement with the social issues themselves.

To highlight some of the trends and nascent developments of potential specialist markets, the cases of healthcare, criminal justice and Fairtrade are highlighted.

### **Healthcare**

UK healthcare is already one of the largest sectors of the UK economy with a total yearly spend estimated at £120bn. The NHS makes up the bulk of this with £104bn (which is 8.2% of GDP) while private health care amounts to £8.7bn and consumer spend on other healthcare products (such as spectacles, contact lenses, etc) is £7.2bn<sup>15</sup>

The market is changing as the NHS's budget will increasingly be committed to commissioning services and products from new providers from the commercial and third sectors. Indeed, the process is already underway in the NHS, with the set-up of commissioning structures alongside other initiatives to support internal change, including the creation of a government investment fund targeting healthcare, an initiative that is currently being developed from within the Department of Health. In addition, people are changing the way they interact and engage with issues of wellbeing and healthcare, providing further opportunities for new innovative providers of healthcare products and services.

In a similar way to what has occurred in the cleantech space, organisations are emerging to market build and market prove. For example the NESTA-Young Foundation Health Innovation Accelerator (*see Figure 12*) nurtures healthcare innovation through supporting early stage ventures. Its approach is based on the fact that healthcare is in the midst of an historic transition. Shaped by the 19th century problems of contagious and acute disease, the National Health Service now has to cope with a new epidemic of long-term conditions such as asthma, diabetes and heart disease. The latest official Health Survey reports that 45% of the adult population of the UK has one or more long-standing illness. For those 75 or over the figure is three quarters. By the end of the last century, long-term conditions accounted for 80% of NHS spending. The acute care of long-term conditions is a primary factor in the continued dominance of hospital spending in the NHS budget (60% in 2003) and the crowding out of long-term investment in prevention (4% in 2002). The State cannot continue to provide a National Health Service without significant innovation or significant increase in the tax burden. If we carry on as normal, public spending on health and long-term care is forecast to rise substantially from 9.4% of GDP in 2004-5 to 11.7% of GDP by 2054-5. It is therefore expected that this area will be particularly fruitful for innovation and new ventures that can achieve social impact while also being commercially sustainable.

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<sup>15</sup> 2006 figures; source: Office of Health Economics

Figure 12  
**NESTA-Young Foundation Health Innovation Accelerator**

The Nesta-Young Foundation Health Innovation Accelerator is an early stage social venture fund that designs, develops and launches new ventures in the field of long-term conditions. Working at the earliest stages of development, from idea conception to launch and initial growth, the fund invests both in entrepreneurs and ideas that come to it externally, as well as developing its own ventures.

Using a staged venture capital style process, the Health Innovation Accelerator provides funding, social capital and entrepreneurial expertise. Launched in late 2007, initial investments have been made in several innovative projects and work is ongoing in engaging with and developing a flow of new ideas from both inside and outside the existing health service alongside accessing entrepreneurial networks, expertise and further strategic and funding partnerships.

### ***Criminal Justice***

The financial cost of crime is enormous; the Home Office puts this at nearly £60 billion a year<sup>16</sup>. This constitutes a rise from 2% of GDP to 2.5% over the last ten years - a higher per capita level than the US or any EU country<sup>17</sup>. The Social Exclusion Unit estimated that re-offending by ex prisoners alone cost the public £11 billion annually<sup>18</sup> while the cost of a prison place is over £40,000 pa per adult and much higher for young offenders<sup>19</sup>. According to recent research, incarceration is the least cost-effective intervention<sup>20</sup> and the system is increasingly seeking ways to innovate.

The Government's new National Offender Management Service creates a split between the commissioning and provision of offender management services including prisons, probation and the management of community sentences and secure healthcare. Between now and 2010, NOMS expects to deliver a significant step change in the way services are commissioned from the public, private and third sectors. This provides an opportunity for private and third sector enterprises to develop this market, building on the small number of contracts currently with commercial companies for the operation of prisons and transportation of offenders. Currently public opinion seems to be set against private involvement in this area and also against the development of alternatives to prison or new kinds of prison. Existing commercial operators bear significant reputational risks and political uncertainty, with the press generally quick to sniff a scandal in any kind of underperformance. However, social enterprises and organisations are better able to weather public opinion and the media and have the potential to introduce innovation into this area for more commercial organisations.

### ***Ethical Consumerism and Fairtrade***

The ethical consumer market is now a significant part of the UK economy, accounting for a spend of over £32bn in 2006 alone. The market encompasses a range of areas, including ethical food and drink, green home products, eco-friendly travel and personal products, all of which are recording areas of growth. Aside from green energy, which recorded a 135% increase in UK consumer annual spend between 2005 and 2006, other particular growth areas have included ethical clothing, cleaning products, and organic produce (see Figure 13).

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<sup>16</sup> <http://www.crimeinfo.org.uk>

<sup>17</sup> *Bromley Briefings: Prison Factfile*. Prison Reform Trust, May 2007

<sup>18</sup> Social Exclusion Unit *Reducing Reoffending Among Ex-Prisoners*, Cabinet Office, 2002

<sup>19</sup> *Bromley Briefings: Prison Factfile*. Prison Reform Trust, May 2007

<sup>20</sup> *The Economic Case For and Against Prison*. Matrix Knowledge Group, 2007

Figure 13  
**Ethical Consumerism in the UK, 2005-6**  
*Main categories and selected sub-categories*

	Spend (£m)		Growth
	2005	2006	
<b>Ethical Food &amp; Drink</b>	<b>4,101</b>	<b>4,795</b>	<b>17%</b>
Organic	1,473	1,737	18%
Fairtrade	195	285	46%
<b>Green Home</b>	<b>5,859</b>	<b>6,186</b>	<b>6%</b>
Energy efficient appliances	1,661	1,824	10%
Ethical cleaning products	27	34	26%
Green Energy	54	127	135%
<b>Eco-Travel &amp; Transport</b>	<b>1,622</b>	<b>1,716</b>	<b>6%</b>
Public transport	377	682	81%
Environmental tourist attractions	16	18	13%
<b>Ethical Personal Products</b>	<b>1,464</b>	<b>1,502</b>	<b>3%</b>
Ethical clothing	29	52	79%
<b>Community</b> <i>(Local Shopping / Charity donations)</i>	<b>5,136</b>	<b>4,873</b>	<b>-5%</b>
Local shopping	2,276	2,585	14%
<b>Ethical Finance</b>	<b>11,555</b>	<b>13,257</b>	<b>15%</b>
Ethical banking	5,020	5,551	11%
Ethical investment	6,098	7,223	18%
<b>Total</b>	<b>29,737</b>	<b>32,329</b>	<b>9%</b>

*For full table see source: The Ethical Consumerism Report (Co-operative Financial Services, 2007)*

Fair Trade, in particular, is an example of another area evolving from an alternative trading mechanism to be closer to the mainstream business sector. The retail value of fair-trade foods alone was £285m in 2006, and the larger players such as Café Direct and the Day Chocolate Company have grown beyond the very small organisations that characterised the sector in its infancy.

Social enterprises targeting ethical consumers are a growing niche and deal flow amongst social investment firms reflect this:

*"We're seeing a lot of environmental and eco-businesses at the moment, and ethical businesses. For instance, a website for people seeking to identify ethical products, an organic meat delivery service, a bio-fuel initiative and a green taxi firm."*

Social Investment Firm

Indeed, there are already a number of specialist funds, such as Triodos, claiming market rate of returns through their investments in this area (*see deal case study, page 56*), while mainstream private equity firms have also dipped a toe in the water, including Phoenix Equity Partners, which recently backed Abel & Cole, the organic vegetable box company.

The potential for venture capital and private equity houses to become directly involved in social and environmental markets that are mainstreaming is clearly highlighted by the process that cleantech and renewable energy has been through. Likewise, examples from the healthcare, criminal justice, and ethical consumerism sectors highlight where similar processes are underway and where there is a strong desire for engagement with people and organisations with mainstream financial experience.

Where private equity houses are investing in venture sectors with a 'clean', social or community focus alongside investments in traditional commercial sectors, there is also potential for cross learnings between portfolio companies. Likewise, the market making that is taking place at the early stage end of the market is rapidly leading to growth and opportunities for mid-market investment, thereby becoming relevant for a much broader proportion of the private equity community.

## 4 Social Investment

### Recommendations

1. Identify organisations to support or partner with which are already active and applying innovative approaches within the social investment sector as a way to gain understanding, filter potential support opportunities and achieve a greater impact. Look for partners with aligned objectives where addition of further expertise and experience could make a substantial impact.
2. Facilitate a more mature sector by supporting development of:
  - Wholesale markets – the Social Investment Bank (with funds from dormant accounts) provides a great opportunity to act as a catalyst for further market evolution.
  - Advisory capacity – like the mainstream PE sector, advisory organisations including legal, consulting, finance and HR capabilities need to understand the opportunities in the sector.
  - Sector specific funds – from health to social care, supporting organisations already active in the sector can help them achieve greater impact and build the market.
3. Explore potential with government for tax relief on investment in funds with a social mission to help increase the flow of capital into the sector and build broader interest in investment models to achieve social change.

### Section 4.1

#### The Social Investment Sector

Just as with the commercial sector, individuals and organisations within the ‘third sector’ have increasingly sought entrepreneurial solutions to social and environmental problems. This is leading to the development of a social investment sector, where there is a particular focus on creating strong organisations that maximise their ability to be self-sustaining, are able to go to scale, and have a developed understanding of the nature of their impact and seek to maximise it.

#### **Systemic Issues**

The innovation-oriented approach that is emerging is, in part, a response to historic systemic issues faced by the third sector. It is a space that has been characterised as shaped like an hour-glass, dominated by small charities at one end and big name organisations at the other, with little in between. There are, therefore, specific issues in terms of the desire and ability to scale third sector organisations, including charities, not-for-profit organisations, community interest companies and so on.

A key feature of the social sector has been a gap in funding for organisations which have the potential to scale. Early stage initiatives are often seen as inherently high risk and in need of capacity building expertise to move them on. The economies of scale are therefore often low, while transaction costs are high.

*“If a fund were making investments in social enterprises in the £50-500k space, the due diligence and transaction fees, the staff overheads would really impact on the returns. Effectively, an investment in such a fund would need to be written off. For these reasons, funds in the social sphere tend to slant towards larger, more obviously commercial opportunities.”*

Social Investment Fund

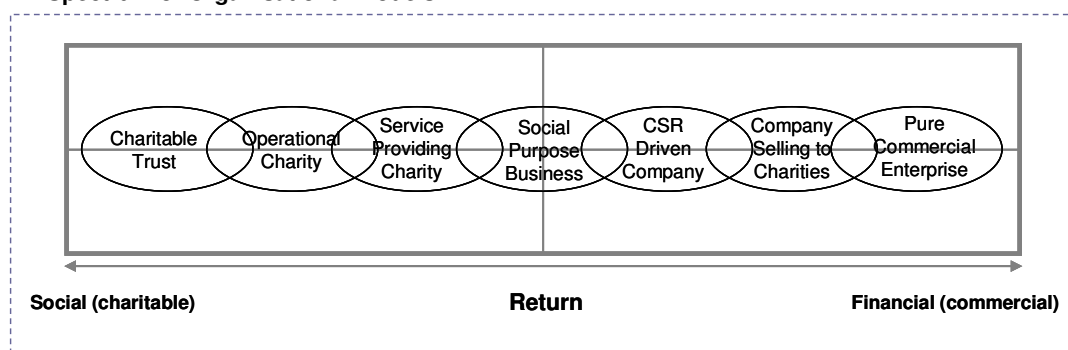
Particular issues within third sector organisations include a lack of capacity-building finance and support, risk adversity and concerns about the impact of more innovative or riskier

funding structures in terms of the organisation's mission, as well as associated issues of incentivising social entrepreneurs.

*"Once a social enterprise reaches the £3-4m size, it is very hard to get the necessary expertise and funding to take them to the next stage in their growth. They tend to just stop growing because it is just so difficult to achieve scale in the sector."*  
 Large Buyout House

A broad range of underlying organisations fall within the social sector, which potentially includes everything from charities with no trading revenue, social enterprises that re-invest some or all of their profits in their mission, and commercial, revenue-generating businesses with a social purpose (see Figure 14). These organisations also have a variety of legal forms (registered charities, community interest companies, limited companies etc.) which, together with their revenue generation model, determines which funding types and structures are appropriate. For instance, loans tend to require assets as security, quasi-equity requires distributable profits, and equity requires ownership. Third sector organisations are often restricted by features such as asset locks and dividend caps.

Figure 14  
**A Spectrum of Organisational Models**



Source: Venturesome

The common thread linking these organisations is that their principal aim is to tackle a particular social issue. However, this could involve organisations across any sector, including consumer sectors (such as fair trade organisations), service providers (such as NHS Direct<sup>21</sup> and Language Line), technology (e.g. the \$100 computer campaign), and welfare (e.g. helping people back to work, supporting education initiatives), for example. Across all these sectors, a range of funding models can be applied, from non-profit to fully-commercial – examples of the range of potential investment models are provided in Appendix 3, with specific reference to the education sector.

### Requirements

The diversity in the specific nature of organisations requiring support, and the fact different organisations need different types of support at different stages in the life cycle, requires a spectrum of funding and operational development solutions. However, the funding ecosystem that exists is nascent and fragile, unlike the more evolved framework that has evolved over more than 30 years in the venture capital and private equity world. Thus, while funding and skills gaps arguably still exist at various points in the spectrum for mainstream businesses, particularly at the early stage end of the market, they are generally felt more acutely by third sector organisations.

However, while there are therefore practical demand side arguments for the development of a range of innovative funding solutions, there is still a job to be done in terms of demonstrating the benefits to third sector organisations. Many in the social sector remain sceptical about the

<sup>21</sup> NHS Direct was based on a concept first developed by Michael Young, a well-known social entrepreneur.



merits of different funding types and approaches, and in particular those perceived to be originating from a commercial standpoint.

Indeed, research carried out by Warwick Business School<sup>22</sup> in 2006, demonstrated that social enterprises don't necessarily suffer from poorer access to commercial finance than their mainstream counterparts, but that their take-up of these financing sources is low relative to mainstream enterprises. In relation to equity finance, the research showed that the percentage of social enterprises seeking equity finance was significantly lower (0.9%) than mainstream businesses (3%).

Potential barriers for social enterprises when it comes to taking on commercial finance include: i) a misalignment between the mission of the social enterprises and the financial objectives of mainstream finance providers leading to moral hazard issues; ii) a perceived lack of understanding of social enterprises amongst mainstream finance providers; and iii) risk adversity and a lack of awareness of the types and sources of funding available to social enterprises.

*"Social entrepreneurs have a real issue with the language of the commercial world. If I were to ask a social entrepreneur if they were willing to give up ownership in return for capital, the answer would probably be no. If I asked them if they would be willing to share profits, then they would probably say yes. There is a lack of understanding, borne of the different motivations of individuals within the social and commercial worlds. Commercial people are profit motivated, while social entrepreneurs want to change society or protect the environment."*

Social Investment Fund

To help address the divide that often remains between social enterprises and the mainstream capital markets, organisations are emerging to provide entrepreneurship and venturing education for those in the third sector, including, for example, the INSEAD Social Entrepreneurship Programme. There is also a basic need for raising awareness of the potential that an entrepreneurial approach can offer in terms of social innovation, and for highlighting the different ways to access key skills, knowledge and funding.

The Government is also involved in addressing this divide at a grassroots level, through its Social Enterprise Action Plan, which outlined the following key commitments:

1. Fostering a culture of social enterprise, especially by inspiring the next generation to start thinking about the social impact of business
2. Improving the business advice, information and support available to social enterprises
3. Tackling the barriers to access to finance that restrict the growth of social enterprises
4. Enabling social enterprises to work effectively with government to develop policy in areas of expertise

There is also a need for clearer signposting and opportunities for networking between the third sector and those in more mainstream business communities, including venture capital and private equity. The inclusion of third sector investors in a separate affordable category of BVCA membership would provide a good first step in raising the profile of social investment firms within the mainstream investment community. Workshops and seminars covering themes such as fundraising, defining a market, risk, and scaling strategies would also provide a way for third sector organisations to tap into the accumulated knowledge of private equity firms. Likewise, the development of a directory (in the Director Bank mould) of industry executives keen to provide time and money to third sector organisations would help remove lack of knowledge of how to find interested parties as a barrier.

*"The sector is just not developed enough – there are more entrepreneurs entering the space, but there is a massive need for education, and that includes helping them to understand the financial products available to them, beyond grants and bank funding. ... There is often some investment readiness work to be done with these groups, and we often team up with foundations to scrape capital together and build capacity."*

Social Business Angel Network

<sup>22</sup> Source: 'Finance for Small and Medium-Sized Enterprises: Comparisons of Social Enterprises and Mainstream Businesses.'

### **Government Support**

The third sector remains fragmented, under-capitalised and financially fragile, with insecure access to funds. In addition, grant dependence can lead third sector organisations to be more focused on individual projects, rather than longer-term organisational sustainability<sup>23</sup>. Engagement from a range of public and private sector organisations is therefore required to support the development of a funding 'ecosystem'.

In addition to the grass roots initiatives already highlighted, the role of government is particularly significant in terms of creating an environment in which entrepreneurial solutions to social and environmental problems can develop. Indeed, despite the skills and funding gaps, the UK is widely seen as being fairly progressive in this regard, with a variety of government supported initiatives having helped pioneer and support entrepreneurial approaches to social issues. It is widely believed that the changing nature of the social contract, in the face of demographic factors and the cost of welfare, means that social entrepreneurship as a mechanism for innovation is now an embedded trend.

The UK also has a number of organisational structures and tax relief features which are now active and are intended to support entrepreneurship in the social sector. In particular the Community Interest Company (CIC) and Community Interest Tax Relief (CITR) (*see Figure 15, below*).

Figure 15  
**CICs and CITR**

#### **Community Interest Company (CICs)**

Community Interest Companies (CICs) are limited companies, with special additional features, created for the use of people who want to conduct a business or other activity for community benefit, and not purely for private advantage. This is achieved by a "community interest test" and "asset lock", which ensure that the CIC is established for community purposes and the assets and profits are dedicated to these purposes. Registration of a company as a CIC has to be approved by the Regulator who also has a continuing monitoring and enforcement role.

[www.cicregulator.gov.uk](http://www.cicregulator.gov.uk)

#### **Community Interest Tax Relief (CITR)**

Set up following recommendation from Social Investment Task Force and enacted with Finance Act 2002

- Offers tax incentives to investors in accredited community development finance institutions (CDFIs)
- Tax incentive is available to individuals and companies in the form of a reduction in income or corporate tax liability
- Accredited CDFIs:
  - Lend and invest in deprived areas via equity and debt
  - Are set up with a 5+ years intended lifetime
  - Must direct 75% of their activity to provision of finance or finance and business advice to SMEs in deprived communities
  - Must only lend to organisations unable to raise finance elsewhere
  - Invest in geographically delineated areas

(More information can be found at [www.philanthropyuk.org](http://www.philanthropyuk.org))

While such measures were perhaps introduced too recently for their success or otherwise to be fully established, they do highlight the commitment to engagement with the social entrepreneurship model in the UK. However, those active in the sector already see the potential for extending some of these initiatives. In particular, CITR is currently very narrowly defined and there are calls for it to be extended and for the restrictions on CDFIs deploying CITR capital to be eased. Likewise, there is the potential to explore options for provision of tax relief on investment in funds with a social mission as a way of increasing the flow of capital into the sector and in building broader interest in investment models to achieve social change. In addition, a new category of 'social investment fund' could be developed where donations made would receive the same tax treatment as donations to charity. These social

<sup>23</sup> Source: 'The Social Investment Bank' (The Commission for Unclaimed Assets, March 2007)

investment funds would have the power to provide funding and support not just to charities but other kinds of social enterprise and social businesses.

The role of the government appears to be most effective when acting as a catalyst, providing cornerstone funding to new initiatives which are intended to draw in mainstream organisations. The cornerstone investment provided for the first Bridges Ventures fund (*see case study, page 55*), for example, served to mitigate risk for other investors, while simultaneously enabling the first fund to prove the market and the model. The organisation was then able to raise a second fund, without government backing, on an established track record.

Non-governmental organisations operating in the social investment space are engaged in building a more coherent 'market' through taking a more holistic view of how social innovation is achieved. This involves a focus on the 'organisation', rather than a particular project, as a central element. An array of organisations are consequently emerging that are applying rigorous techniques to support social initiatives, and in so doing are adopting elements of a venture capital approach and are balancing out the twin outputs of a social impact and return with financial sustainability and a financial return. The creation of a development capital culture and market is a key element in ensuring that 'good' ideas have the opportunity to achieve maximum impact, and grow to scale.

## Section 4.2

### **Funding Models**

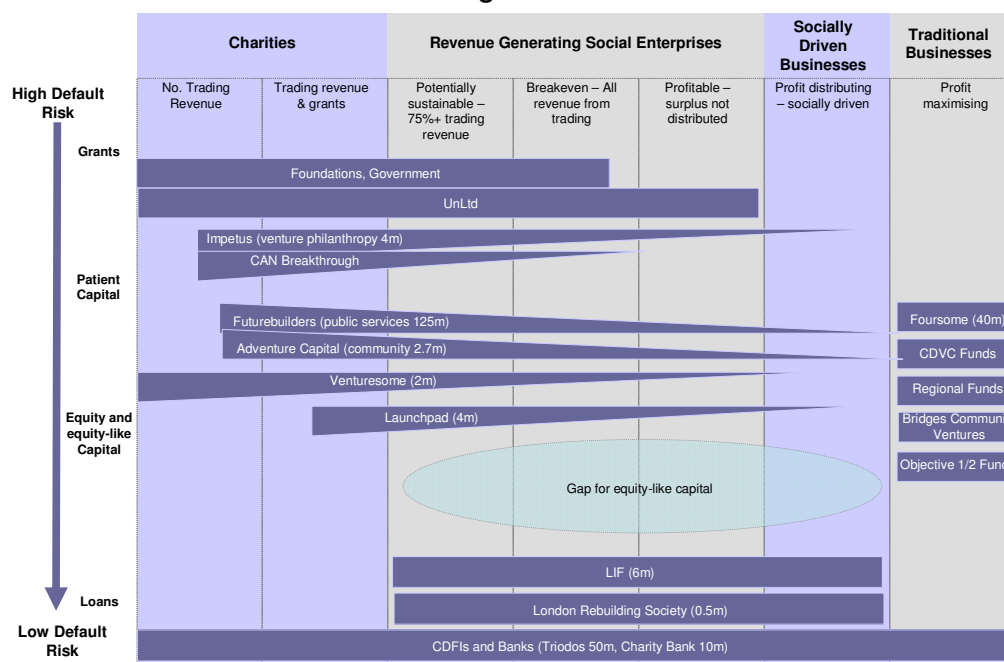
Within the social investment arena, an array of intermediary funding organisations are emerging, targeting different types of underlying organisation through a variety of funding models and with varying expectations in terms of the nature of the 'return' generated. This includes organisations providing grant-based support and expecting a purely social return, though those using more creative funding structures to support organisations in generating both a social return and a degree of financial sustainability (via a financial return), to those with a more evolved model which seeks to generate a positive social impact through the use of more mainstream financing techniques, instruments and networks.

The following diagram (*see Figure 16*), based on one developed for UnLtd by McKinsey & Co (2004), highlights the nature of the social investment area and some of the key players across the various support models.

At one end of the funding spectrum, therefore, are those organisations most clearly aligned with the traditional venture capital model, including organisations such as Triodos. These organisations operate a mission-driven investment strategy, targeting enterprises whose social impact is aligned with their commercial performance (i.e. the better the company does financially, the greater the social impact). Sectors where an alignment of social and financial return exists include Fair Trade organisations or other ethical retail and consumer services businesses. Other sectors such as healthcare, education and the environment can also yield investment opportunities where commercial success and social impact are aligned.

With Bridges Ventures, the focus has been on selecting businesses in deprived communities, where a successful investment produces both a financial return and boosts local employment. Triodos takes a more sector-focused approach, targeting ethical businesses with a social mission in sectors such as ethical consumer products, organics, natural healthcare and environmental enterprise. The firm has completed a number of transactions, including Aarstiderne A/S (*see case study, page 56*), highlighting the ability to generate commercial return, while supporting a social mission.

Figure 16  
**Social Investment for Third Sector Organisations**



There have also been examples of buyouts, where the underlying business has been transformed into a social enterprise by employing marginalised groups (e.g. the disabled or the homeless). Through the success of the company, such ventures are directly able to improve the lot of their employees. An example is 'Bonsai – The Imagination Tree' in Australia, which is a successful nursery, supplying bonsai trees to large retailers. The business was bought out by Social Firms Australia, in order to convert it into a business that provides employment opportunities for people with disabilities, particularly psychiatric disabilities. A similar model is currently being explored by Nigel Kershaw of Big Issue Invest.

Another example of a mainstream financing model applied to the third sector is Charity Bank, which provides debt funding to social enterprises. Charity Bank has sought to access funds by adopting a traditional retail bank model, which enables individuals to make deposits, as with any high street bank, which are then used to support social enterprises.

In the centre of the social investment space organisations have emerged providing debt and 'equity like' products, together with hands-on support, to social enterprises. Organisations in this part of the market aim to recycle the capital they provide to social enterprises to maximise its impact, and therefore seek a certain level of financial return. The aim of the financial return in these instances, therefore, is one of sustainability and benefiting the social impact, rather than the aim being to maximise the financial return for its own end: a poor financial return does not therefore constitute a failure, if the social return is high. Organisations in this part of the third sector are therefore often looking at ways to quantify the social return to prove the model and attract further funding. Key organisations active within this part of the market include Big Issue Invest, Launchpad, Good Capital, Untld Ventures, Venturesome, and Adventure Capital.

At the grant funding end of the spectrum, the model becomes synonymous with venture philanthropy (*see following chapter*), with the emphasis being on supporting charitable organisations where there is minimum potential for commercialisation. Grant funding currently remains the dominant means of supporting the majority of charitable organisations. The venture philanthropy model is part of a broader shift within grant-making bodies towards a more engaged approach, but only represents a very small part of the area. However, this part of the market continues to require funding as well as skills. Key organisations active within this space include initiatives within the private equity field such as the Private Equity Foundation, Impetus and the CAN/Breakthrough initiatives (in conjunction with Permira).

### Section 4.3

#### **The Role of Private Equity in Developing a Social Investment Infrastructure**

Support for third sector organisations is increasingly taking a broader range of forms, and there is therefore much greater potential for private equity firms to think creatively about their approaches to charitable activities. The relevance of the venture capital model, the skills and funding gaps within the social sector, and a willingness amongst social investment firms to engage with the industry has created a real opportunity for creative collaboration. Organisations active in the Third Sector can provide an opportunity to blend different skill sets from the social and business sectors to boost social impact. In turn, they are increasingly providing a framework for executives within private equity and other industries to engage directly with third sector organisations.

There are a raft of new opportunities emerging that would benefit greatly from the support of the private equity industry providing cornerstone investments (*see case studies of Social Investment Funds*). In particular, the organisations and funds that are emerging with a more venture capital approach also require skills and expertise to drive the development of this part of the market, and have a particular resonance in terms of approach with the mainstream private equity community.

*“The private equity industry could also play a corner-stoning type role. If private equity houses can provide the first 20% of a fund, it makes fundraising a much easier process. Investment might initially be on a loss-leader type basis.”*

Social Investment Organisation

Private equity engagement of this nature therefore serves a number of purposes. Alongside, the essential provision of funding and skills to support underlying initiatives to address social and environmental needs, it can support the organisations described in this report that are actively engaged in the process of market building and proving. This process aims to both create viable and sustainable models for addressing social and environmental needs, and also to bring this sector into the mainstream to attract greater funding from more institutional financial sources.

Barriers to attracting institutional money into the third sector have included, first, a lack of structures that mesh well with mainstream investment practices and, second, as has been highlighted elsewhere, an understanding of the nature of the social and commercial elements of the returns.

Across the social investment part of the spectrum organisations such as Triodos, Bridges, Charity Bank/Venturesome and others are adopting forms that mirror the ways in which more institutionalised financial services organisations operate, in order to attract funding. Investments are therefore being sought where a financial return is achievable in pursuit of the social impact, thereby successfully attracting mainstream institutional investors such as All Souls College, Universities Superannuation Scheme, and West Midland Pension Fund.

The case of Launchpad provides some further context. Its early stage social venture funds invest at the earliest stages of an idea/project and aim to achieve high social returns by applying an entrepreneurial model of venture development. Investors in these funds invest on the basis that a social return is the primary objective, but where a financial return can be made aligned with achieving social impact, any financial returns are recycled to invest in additional projects. Investors also seek to experiment with new models of social venture development and a range of equity and hybrid investment forms designed to apply the most relevant approach to achieve social impact.

One of the strengths of the Social Investment Bank model in terms of engaging with the mainstream and building a more coherent funding ecosystem is its positioning, sitting with one foot within the mainstream community. Other organisations are pursuing a similar approach in different areas. For example, at an international level, Ashoka has been working with financial organisations to create vehicles that draw on expertise from both the financial world and third sector. One of Ashoka's programs to address financial support for social ventures is the Eye Fund initiative which was established in conjunction with Deutsche Bank

to provide eye-care services in developing countries. Separately, Ashoka has also been looking at ways in which financial instruments such as CDOs and securitisation might be used in relation to funding a sanitation initiative. This follows examples such as an immunisation initiative (International Finance Facility for Immunisation), developed by Goldman Sachs on behalf of six European governments, and the Clinton Climate Initiative, both of which use innovative financial structures to provide a more consistent flow of capital to support solutions to particular environmental and social problems.

Many of the organisations described in this report are actively engaged in understanding the nature of social and commercial returns in order to prove their models. Across the social investment segment of the third sector, commercial returns tend to be inversely related to social returns. A fully-aligned commercial and social strategy is therefore still relevant for only a relatively small part of the market. While this highlights the potential for a 'venture capital model' to be deployed both for the social good and a commercial return, it currently remains a nascent market. In terms of attracting institutional funding, therefore, blending social and commercial approaches can fall between the two stools of investment and philanthropy and the case needs to be made for institutions to look at social investment from an investment, rather than a philanthropic, perspective.

In the US, there is already an established philanthropic culture within Endowment funds, which therefore represents a significant opportunity for such a migration from philanthropy to investment. One of the challenges therefore being addressed by organisations in this part of the market is to engage with mainstream organisations, including private equity houses, to build the funding ecosystem, prove the model, and encourage a migration from philanthropy to social investment. On both sides of the Atlantic, few institutional funds currently exist. However, the success of Bridges in raising institutional money on a commercial basis alongside the government corner-stone and support from within the private equity industry is a key example of one model.

However, government sponsorship is not the only model. In the UK, Catalyst Fund Management & Research in partnership with Big Issue Invest has recently launched a £25m institutional fund focusing on ethical consumerism, with a £5m cornerstone from Barclays Bank. Similarly, Good Capital (*see case study, page 57*) in the US provides an example of the issues faced in bringing such a vehicle to market.

Currently there are two schools of thought in terms of marketing social investment funds. First, highlighting the commercial return as the means of attracting investors and generating the social return via the nature of the investment remit. Second, positioning the return as a super-charged social return; the strategy for generating the social return involves making the capital work as hard as possible by recycling it as much as possible. This therefore also implies a degree of financial return being generated. In both instances, the commercial return will tend to fall below average mainstream venture capital market levels, and perhaps be in the range of 7-12%.

The intermediary organisations described in this section are therefore building organisations which are looking to draw on the best of financial expertise and the best of third sector experience to create sustainable mainstream models for addressing third sector issues. In so doing, they are looking for engagement with organisations, such as private equity houses, that is beyond just charitable donations. For private equity houses, there is an opportunity to become engaged in initiatives targeting a greater and a longer-term impact in terms of direct charitable activities, as well as in relation to the building of the long-term sustainability of the third sector ecosystem.

*"There is a definite opportunity for initiatives that are more risk-orientated within the investment space. It would make good business sense for a private equity firm to be involved in a higher risk, social investment fund from a strategic alignment point of view. If firms are going to give their money away, they might as well invest it."*

Social Investment Fund

# 5 High Engagement and Venture Philanthropy

## Recommendations

1. Firms should approach charitable giving with similar rigour and intensity to that of core business, applying team skills and expertise, to facilitate a greater social impact.
2. Firms should set their own specific targets for engagement of money, time, and network (or a combination) on social issues. This could equal or better targets set in other sectors. For example leading businesses have suggested a target of 1% of pre-tax profits and time for commitment to social causes; although not all reach this target, it provides a possible benchmark for the private equity industry.
3. Firms should partner with active organisations / intermediaries within the social sector as this can provide a more effective way of addressing the issues than direct interventions, tapping into the deep expertise and networks that already exist within the third sector.
4. Staff should be encouraged to participate by leveraging their professional skills to create a positive social impact. This can be highly rewarding and has benefits in terms of personal and professional development.
5. Work with the Venture Philanthropy sector to evaluate what models and methods could be applied to achieve social impact. Private equity skills and resources are highly valued within the charitable sector and there is a desire to collaborate to develop new initiatives and innovative approaches.

### Section 5.1

#### The Evolution of Philanthropy

The philanthropic tradition is well established, with those that have generated significant personal wealth following in the footsteps of individuals such as Andrew Carnegie in believing that *“Surplus wealth is a sacred trust, to be administered during life by its possessor for the best good of his fellow-men”*<sup>24</sup>. However, there is a growing trend towards a more ‘engaged’ style of philanthropy, with donors seeking to take a more hands-on role in ensuring that they are fully maximising the social impact of their philanthropic activities. This, in part, reflects the significant wealth creation that has occurred over the past decade, the increasingly entrepreneurial origins of that wealth, and an associated ethos, which both seeks to apply a similar approach to philanthropic acts as to core business and questions the merit of simply passing on wealth directly to heirs. As previously noted, recent figures suggest that, while 15 years ago 75% of the UK’s richest individuals had inherited their wealth, today the picture is one of 75% having generated their wealth through their own endeavours.

*“Over the last five years, there has been a growing interest in philanthropy amongst entrepreneurs and executives from the private equity, hedge fund and financial services industries. The profile of philanthropists is changing and this is reflected in the ways they are deploying the capital.”*

Philanthropy Advisor

Against the backdrop of the broader trend towards ‘high engagement’ philanthropy, a number of interesting models are emerging in the UK, amongst them venture philanthropy. Venture philanthropy has taken root in the UK over the past six or so years, with Stephen Dawson’s launch of Impetus Trust in 2002 representing the first independent venture philanthropy organisation to be established in Europe. The venture philanthropy community is small and the market is nascent, but interest in the model is growing. The term ‘venture philanthropy’ refers to the application of certain principals traditionally associated with the venture capital world to build capacity in not-for-profit organisations or social enterprises<sup>25</sup>. The model

<sup>24</sup> Quoted in “Philanthropy: Self-made want to be hands-on donors” (FT.com; 14.12.07)

<sup>25</sup> Source: “Venture philanthropy: a new concept or an old idea re-wrapped?” Speech to the Association of Charitable Foundations by David Carrington, April 2003

therefore involves the provision not only of money (usually grants), but also organisational support and advice, to provide a higher level of engagement than is the case with traditional philanthropy, grant making or charitable giving.

## Section 5.2

### The Role of Venture Philanthropy

Within the third sector, there are many hundreds of charities in the UK. However, only a proportion of these will have the desire, potential or resources to go to scale. As with other parts of the third sector support spectrum outlined in this report, gaps exist in terms of the provision of funding and skills to help charities scale.

*"The charitable sector is funnel shaped, with a large base of charities in the sub-£1m revenue space and a community of charities in the £10-30m+ space, with little in the middle. Making the transition from a small to a large, sustainable organisation is incredibly difficult and the nature of funding is such that it is hard to invest in the infrastructure and processes necessary to make that transition."*

Philanthropy Advisory Firm

There are a number of revenue streams available to charities, ranging from unrestricted 'gift' capital, including philanthropic giving, voluntary donations and pure charity, through grant funding, which tends to be short term and restricted in terms of uses and expected outcomes, to trading revenue, either from public sector contracts or from an affiliated social enterprise. Trading revenue generated, either from the public or private sectors, often fails to cover costs<sup>26</sup>, while restricted grant funding, which makes up around 75% of a charity's income<sup>27</sup>, tends to be highly project-focused and provides little opportunity for organisations to adapt or change. Finally, 'gifted' capital, which has the least restrictions, tends to be most accessible for the largest, high profile organisations, which have public recognition and therefore support. A recent report by the Commission for Unclaimed Assets<sup>28</sup> highlights these issues, and demonstrates the fact that smaller charities are significantly disadvantaged in terms of their ability to generate income, particularly to support growth and development.

The venture philanthropy model is therefore aimed at addressing the needs of these organisations in particular – i.e. those that have both the desire and potential to make a step-change in their development but are unable to access the funding and skills necessary to be able to commit the resource to do so.

Charities seeking to achieve scale therefore require support that is both ongoing and holistic. This has particular resonance with the venture capital approach, in that attention is focussed on the entrepreneur and organisation, rather than supporting a particular one-off project. The focus may therefore be on building the organisational infrastructure necessary to achieve the charity's top-level mission, including strategic planning, management and team building and putting in place structures and processes to support more effective fundraising and deployment of capital raised. In terms of the philanthropic funding, therefore, financial support maybe more usefully directed to backing core functions, rather than in 'direct' support of the charity's mission.

## Section 5.3

### The Development of Venture Philanthropy in Europe

While the term 'venture philanthropy' was first coined in 1969 by John D Rockefeller III<sup>29</sup>, the approach gained real momentum in the US during the post-dotcom era, when it became controversially associated with a growing community of newly-wealthy entrepreneurs seeking

<sup>26</sup> A recent charity commission survey found that 43% of respondents don't receive full cost recovery for the services they deliver, and a further 37% only receive full cost for 'some' or 'most' of their services.

<sup>27</sup> Based on analysis by the Commission for Unclaimed Assets of the Guidestar UK Database

<sup>28</sup> 'The Social Investment Bank: Its organisation and Role in Driving Development of the Third Sector.' March 2007

<sup>29</sup> 'Venture Philanthropy: The Emergence of High Engagement Philanthropy in Europe', Rob John June 2006



to apply both their wealth and their commercial skills to the charitable sector. The perceived hubris of these 'new philanthropists', who sought to transform the charitable sector, alienated segments of the traditional grant making community, a rift that has yet to fully heal.

*"Venture philanthropists have been too strident, too 'pushy' about the wonders of running non-profits like businesses instead of focussing on the importance of strong leadership and good management, too quick to offer solutions to non-profits and too anxious for fast results."*

Mario Morino, Morino Institute

The European venture philanthropy community is keen to take on board the lessons learnt from the US and ensure that the market in Europe grows in a cohesive manner. The European Venture Philanthropy Association has been instrumental in this sense, providing a networking forum for organisations across the social investment market. Indeed, the recent EVPA conference in Madrid saw 300 people come together from over 30 countries and included high-net-worth individuals, entrepreneurs, social investment firms, venture philanthropists, foundations, charitable trusts, academics, professional services firms, private equity and venture capital executives.

In order to encourage this diversity, the EVPA has adopted a broad definition of venture philanthropy covering all stages of the spectrum of support provided to organisations with a social mission, from community development venture capital and social enterprise investment through to traditional venture philanthropy within the charities sector (see Figure 17, below).

'Pure' venture philanthropy remains a small part of the overall philanthropic landscape. However, given the advantages of creating a more coherent support ecosystem within the third sector, it is important that venture philanthropy is integrated within the broader spectrum of organisations that make up the social sector. The EVPA's approach, therefore, seeks to avoid a silo mentality where definitions become narrow and lead to walls being built around particular types of social solution while also creating multiple opportunities for sharing best practice and learning from each other.

Figure 17

### **Venture Philanthropy**

Venture philanthropy is a field of philanthropic activity where private equity / venture capital models are applied in the non-profit and charitable sectors. There are many different forms of venture philanthropy but the EVPA believes it can be characterised as:

- The active partnership, or engagement, of donors, volunteers and/or experts with charities to achieve agreed outcomes such as organisational effectiveness, capacity building or other important change;
- The use of a variety of financing techniques in addition to grants, such as multi-year financing, loans or other financial instruments most appropriate for a charity's needs;
- The capability to provide skills and/or hands-on resources with the objective of adding value to the development of a charity;
- The desire to enable donors to maximise the social return on their investment whether that be as a financial donor or as a volunteer of time and expertise.

Source: European Venture Philanthropy Association ([www.evpa.eu.com](http://www.evpa.eu.com))

## Section 5.4

### **The Venture Philanthropy Landscape**

As within other parts of the spectrum, venture philanthropy organisations take a variety of forms in terms of the types of organisation they support and the manner in which they work with donating individuals and organisations.

In the UK, where venture philanthropy is a relatively new phenomenon, Impetus Trust (see case study, page 65) emerged as one of the first organisations overtly active in the space.

Impetus acts as a focal point for multiple individuals and organisations to donate time and money, harnessing their skills and capital during the investment process to maximise the social impact of the charities it works with. Impetus provides a good example of creative thinking in relation to philanthropy, with former ECI Partners executive Stephen Dawson and his business partner Nat Sloane effectively pioneering the venture philanthropy model in the UK.

The Private Equity Foundation (*see case study, page 66*) is pursuing a similar model, but with a particular focus on supporting charities that address the needs of those individuals that get left behind as a result of the capitalist process. PEF builds on the notion that the European economy is in transition, and that this new phase, characterised by globalisation and a shift towards knowledge- and service-based industries, can leave certain segments of society behind. The initiative was founded in 2006 by a group of European private equity firms, who sought to 'apply private equity to charity' to create value and boost the social impact of the organisations that it supports.

The approach taken by Permira in its joint initiative with CAN, known as Breakthrough, is slightly different in that it is a dedicated JV relationship between the two organisations. Breakthrough is another good example of philanthropic creativity originating from the private equity community. The initiative provides Permira executives with the opportunity to work directly with the social enterprises it backs, providing mentoring support and leveraging their skills to help grow and develop the portfolio.

Ashoka (*see case study, page 66*), is an initiative that originated from within the third sector, founded by social entrepreneur Bill Drayton. The organisation is currently increasing its activity and presence in the UK, focusing on social entrepreneurs as key agents of change. Ashoka identifies and supports those individuals with proven track records in finding new and innovative solutions to social problems and the ability to make a difference at a national or international level, providing them with a living stipend for an average of three years, allowing them to focus full-time on building their institutions and spreading their ideas.

While contingents within the financial services industry are developing their own style of 'engaged' philanthropy, the broader foundation community is already engaged in this movement. While institutions such as the Esmée Fairburn Foundation and the Sainsbury Family Charitable Trusts have pioneered high-engagement social investment initiatives, the venture philanthropy model is also beginning to crop up. For instance, the Lloyds TSB Foundation for Scotland recently created 'Inspiring Scotland', a dedicated venture philanthropy fund seeking to invest £10m per annum in charities, raising funds from a variety of third party sources, including foundations and trusts, individuals, businesses, Scottish government and charities. The fund, due to be launched in 2008, describes itself as 'the first venture philanthropy model to have grown from within the voluntary sector.'

In the US, venture philanthropy has seen a number of different approaches emerge. Blue Ridge Foundation (*see Figure 18*), for example, was established by the founder of Blue Ridge Capital real estate fund. Having spent several years making charitable grants, the foundation later took on independent staff and adopted a more engaged model along an 'incubator' style approach. The Robin Hood Foundation also emerged from the financial community, being originally supported by people from the hedge fund industry, but now raising money from across the financial services community.

**Figure 18**  
**Blue Ridge Foundation**

Blue Ridge Foundation support early start-up non-profit organizations within New York. They aim to develop strategies that help people from high poverty communities to reach their full potential by providing them with opportunities, resources, and support. Working with leading social entrepreneurs to turn innovative ideas into sustainable, effective organisations, Blue Ridge also offer potential funding as well as access to its network of grantees.

## Section 5.5

### Social Impact and Benchmarking

Organisations active within the venture philanthropy segment of the spectrum are focussed on social impact, rather than financial returns. The venture capital model applies, therefore, in terms of the process of assessing and identifying the interventions that will make the greatest impact and monitoring the success of an organisation in maximising this impact.

Consequently, developing ways to measure social impact is highly topical and organisations are actively engaged in identifying ways to address the question of benchmarking. New Philanthropy Capital, for instance, has a highly-evolved process for mapping out particular social issues, including areas such as domestic violence – analysing the different approaches taken to address the issue, the relative impact of different approaches, funding shortages and the gaps in service provision. This enables capital to be more effectively deployed into the organisations likely to generate the best results.

Individual organisations within the venture philanthropy field are also developing their own metrics for measuring social return. For instance, Impetus Trust produces an 'impact report' which highlights the degree to which supported organisations have been able to increase their income, how that growth compares to the charitable sector as a whole, and the increase in the social impact achieved post support (source: [www.impetus.org.uk](http://www.impetus.org.uk)).

Being able to demonstrate impact is also an important stage in market-building (as discussed in previous chapters). New Philanthropy Capital is therefore engaged in an initiative that seeks to promote more effective information sharing, creating an online databank for charities and funders to share information on performance. The project, Results Library, is currently seeking funding (see *Figure 19*).

**Figure 19**  
**Results Library, New Philanthropy Capital**

#### The Problem

The inability to compare the performance of different charities operating in a similar field has implications for decision-making amongst donors and learning amongst charities

#### Drivers

- No standard measurement of 'success' in the charitable sector (i.e. sales / profit for private sector)
- Failure to take into account longer term and indirect impacts of charities
- No incentive for charities to measure success (often not needed to attract funding and takes time and resource)
- No central repository for storing data
- Lack of a culture of information exchange between funders and charities

#### The NPC Solution

- Creation of 'Results Library', an interactive 'Wiki' data Library online, for charities to share their results
- Structured and built through collaboration, collecting together the results and costs of charities' work as well as costs of different social problems to the individual concerned, to the Government and to wider society
- Additionally drawing on social science literature to allow greater exploitation and use of results from research tying social, including charitable, interventions to the public purse, thereby reducing the fragmentation of research findings.

## Section 5.6

### Private Equity Involvement

#### Drivers

Corporate philanthropy, as was highlighted in Chapter 1, has become an important component of the CSR agenda. The evolution of the private equity industry coupled with the

rise of CSR-related issues more broadly has, in turn, led to corporate philanthropy rising up the private equity agenda. The venture philanthropy model, in particular, would seem to offer particular opportunities for private equity firms, as an approach which resonates with the private equity ethos.

While much has been done from within the venture capital and private equity industry on a personal basis (in terms of the provision of both time and money), the emphasis now is shifting towards corporate level engagement.

*"I gave a short presentation to our team to gauge reactions to potentially setting up an initiative, expecting a cynical response ... I highlighted the benefits of such an approach, to which one 26 year old team member replied, 'isn't this just something we should be doing anyway?' Which says it all."*

Mid Market Private Equity House

However, corporate philanthropy can be a contentious issue within businesses, sparking debates over the perceived issues that it raises, including:

1. The public relations implications, particularly in terms of initiatives being seen as cynical ploys
2. The often personal nature of giving and the manner in which this can/should be integrated with a corporate level programme of philanthropy
3. The lack of established modes of engagement with philanthropy and few role models
4. The time cost of setting up a dedicated corporate programme of philanthropy and the perceived lack of intermediaries to assist in this process
5. The challenges associated with providing time as well as money

*'I think the industry is a significant source of philanthropy, from individuals themselves, but I am highly sceptical about the value of industry-level initiatives.'*

Mid Market Private Equity House

### **Modes of engagement**

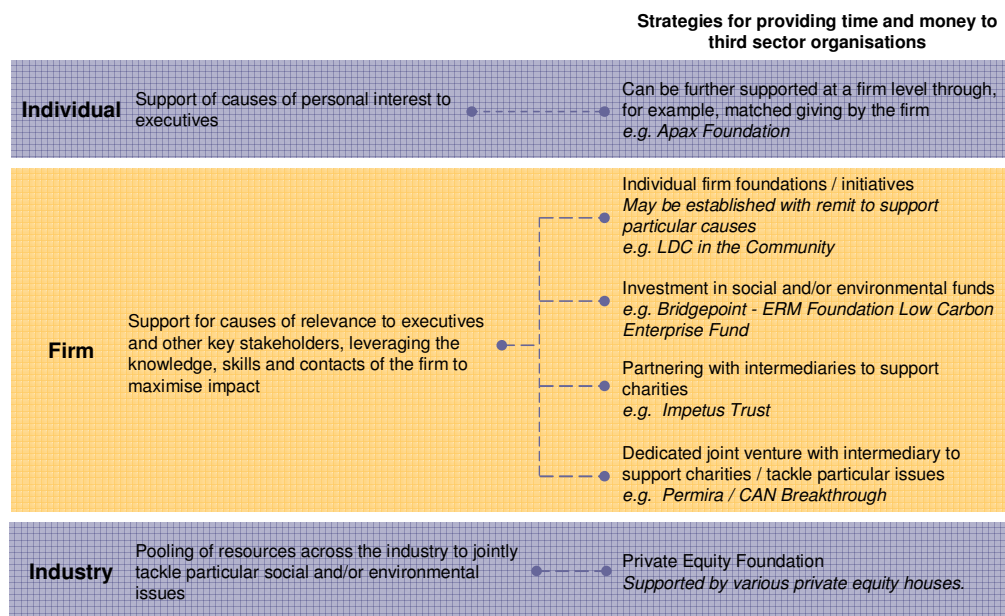
Private equity houses engaging in philanthropy have the opportunity to consider initiatives at three levels, which should all be integrated in the firm's overall approach. First, many individuals are already engaged in philanthropic initiatives. Second, the firm can undertake initiatives of its own which resonate with the core business and build on the firm's own motivations, skills and resources. Third, there is the opportunity for industry-level initiatives, such as the Private Equity Foundation, to be created, pooling considerable resource behind specific social and environmental issues pertinent to the industry (see *Figure 20*).

While private equity firms may be cautious about corporate level philanthropy, there are a number of key benefits associated with adopting a firm-wide approach, driven by senior-level commitment.

Firstly, corporate level engagement provides an opportunity for a firm's partners and staff to put their heads together to come up with a more formalised strategy for giving that resonates with the ethos of that organisation. It also creates a forum for creativity and innovation. For example, Permira's Breakthrough (see *case study, page 62*) joint venture with CAN was set up in response to a desire within Permira to create a more effective philanthropic approach. The Permira team was keen to leverage its skills and experience, as well as capital, to evolve a more engaged strategy within the social sector, while also providing staff from across the team the opportunity to get involved in a hands-on way. On the back of this, the team began to explore the options, resulting in the collaboration with CAN and the creation of the first Breakthrough Fund. The fund provides grant funding to social enterprises with an ambition to scale. Each enterprise backed is allocated a member of the Permira team, who provides mentoring support to the entrepreneur and their team. Following the success of this pilot venture, the concept is being rolled out, with a successor fund currently on the fundraising trail. Prior to the founding of Breakthrough, Permira's philanthropic strategy had been much more ad-hoc and informal. The initiative with CAN has allowed the team to clearly set out its objectives, and measure performance against these. To date, the enterprises that have been

backed by Breakthrough have increased their social impact by 40% and their revenues by 20%.

Figure 20  
**Modes of Engagement with Philanthropy**



See full Case Studies for more information on cited examples

Secondly, pooling creative input and resource across an organisation can significantly increase the impact of a philanthropic venture, by maximising the capital, experience and skills available to the organisations being supported. For instance, LDC was keen to institute community engagement and charitable giving at the heart of its organisation, providing an opportunity for everyone within the firm to get involved at some level. The group created its 'LDC in the Community' initiative, which resonates strongly with the team's regional market approach to business. The team undertakes a variety of initiatives, often championed at a local level by the regional teams, and has boosted its charitable giving by a factor of ten over the past three years, committing £300,000 in 2007 (see case study, page 61).

Another example of a sustainable initiative, this time in the environmental area, is the ERM Low Carbon Enterprise Fund, which is being corner-stoned by Bridgepoint (see case study, page 63). This fund, which seeks to raise \$2m, provides loans and equity to entrepreneurs and businesses in the developing world wanting to reduce global carbon emissions and support local livelihoods. The fund will effectively be a 'permanent' pool of capital, with all returns re-invested in further projects, optimising the social and environmental impact of the funding. Bridgepoint had been seeking to quantify the social and environmental impact of its organisation as part of its CSR strategy, and the Low Carbon Enterprise Fund offered an opportunity for the team to invest in a highly sustainable initiative that was supporting entrepreneurial low carbon businesses.

In both the Bridges and the ERM cases, the private equity firms provided both capital and resource, which further optimised the impact of those ventures:

*"Bridges was enormously assisted by the backing of Apax, 3i and Doughty Hanson. We draw on our private equity partners for advice on new investments, for non-executive directors and access to their networks."*

Michele Giddens, founder, Bridges Ventures.

Thirdly, a formalised philanthropic strategy also allows a firm to set their own objectives, perhaps focusing on a particular social or environmental issue, setting parameters for levels of commitment across the team, outlining the strategy and setting realistic performance

targets and expected outputs. For example, the Apax Foundation focuses on supporting entrepreneurial, social investment and educational initiatives that work towards the alleviation of poverty in deprived communities worldwide, while the Doughty Hanson Charitable Foundation focuses on fighting poverty, disability, homelessness and promoting healthcare and education in all sections of society. A more focused strategy, perhaps selecting a single social issue, enables knowledge to be accumulated and a more effective strategy to evolve; it also creates an opportunity to have a real and measurable social impact. While a 'spray-and-pray' approach to charitable giving can provide firms with an initial flavour of the third sector, the actual impact of the capital donated can be difficult to gauge.

Fourthly, a corporate philanthropy strategy also provides a framework for maximising the efficiency of the programme, creating a formal structure that can provide individual team members with the latitude to get personally involved while minimising the disruption to their day-to-day professional lives. The concern that a corporate commitment could suck up considerable resource, particularly given that private equity firms are relatively lean organisations, is an important consideration.

Setting in place a formal framework also serves to create a more sustainable model for the future, putting in place processes and structures that will help minimise the potential for failure or loss of momentum.

Finally, those within private equity that have been involved in direct engagement with third sector organisations outside the core investment remit often report that the experiences have yielded broader benefits in terms of business education and staff motivation.

Indeed, our straw poll reveals that of those individuals that have been personally involved in a social venture as part of their firm's philanthropic activity, 84% found the experience positive from a personal development point of view, while 61% found it positive in terms of their business education. An important part of creating a structured programme, is building a culture within the firm that allows philanthropy to thrive at all levels of an organisation.

Creating a philanthropic culture within a firm involves supporting a philanthropic programme throughout the organisation with senior level support, making it easy and desirable for executives to participate. For instance, 3i has instituted a 'Give As You Earn' scheme as part of its programme of corporate philanthropy, which matches the donations given by UK staff and the proceeds of staff fundraising efforts. In 2007, 25% of the firm's charitable donations went to the scheme. The Apax Foundation has a similar scheme, matching personal donations of executives on a 2:1 basis with support increasing where the executive has a direct (i.e. time commitment) relationship with that organisation (*see case study, page 64*).

Likewise, LDC encourages the participation of the whole organisation, hosting team-wide fundraising events, including an annual quiz, which takes place across six venues, with 140 teams involved. The group also has 40 of its team members in training for this year's London Marathon.

A corporate level approach should therefore build on what individuals within the team are involved with on a personal level thereby enhancing, rather than replacing, those initiatives. Similarly, corporate level engagement offers the opportunity to support the existing charitable and philanthropic initiatives of key stakeholders (portfolio companies, investors).

### ***Philanthropy Roadmap***

Developing an effective philanthropic programme is something which takes time and needs to evolve as experience grows. Philanthropy is often thought about primarily in terms of the charitable giving of money and time. However, with the broadening nature of organisations pursuing social ends, as well as those supporting them, an integrated philanthropic programme can move towards a more evolutionary approach that resonates with the donator.

There is, therefore, potentially a staged process of engagement whereby a philanthropic culture is built and supported and the firm becomes progressively more engaged.

## Stages

1. Supporting executives and other stakeholders in their philanthropic initiatives
2. Providing a mechanism (e.g. through charity accounts, matched donations, supporting employee-led initiatives) for encouraging those not yet involved / new employees to become involved in both the giving of money and time
3. Engaging with external organisations to help formalise approach (e.g. establishing a house fund/foundation, engaging an intermediary such as New Philanthropy Capital or Coutts)
4. Appointing a senior internal champion, setting targets for levels of engagement and developing a programme that considers the nature of engagement at the level of the individual, the firm, and the industry
5. Other initiatives: Thinking creatively to leverage in-house skills to address social and environmental issues

As has already been noted (*see previous chapter*), the cultural divide between the social and business worlds, in terms of language, approach and motivations, tends to be cited as a barrier to greater engagement. The underlying third sector organisations may be wary of the 'financial community', sensitive to the potential for compromising their mission, while the change in pace and the culture of the charitable sector can prove frustrating for business professionals.

*"I worked with a charity, and it was the hardest thing I ever did. There is little alignment, as the individuals involved have entirely different motivations and you can't fire them!"*  
Mainstream Private Equity

Bridging the gaps in approach, aims and culture is key to understanding in what ways skills and knowledge used in the commercial sphere could also be helpful in the social sphere and third party intermediary organisations provide a mechanism in this regard.

### **Third Party Intermediaries**

As outlined in the previous chapter, there is a growing community of intermediary organisations already providing support and capital to organisations within the third sector, which would benefit from increased engagement from the private equity industry. These include those at the commercial end of the scale (e.g. Bridges Community Ventures, Triodos etc.) which fundraise in a similar way to traditional mainstream private equity houses, or organisations developing a banking model (e.g. Charity Bank, Social Investment Bank), through to organisations which seek to apply entrepreneurial and commercial learning to maximising the impact and the scaling of social ventures and charities (e.g. Impetus, Venturesome, Launchpad, Private Equity Foundation etc).

As highlighted earlier, in a lean industry like private equity, a high-engagement model presents real practical challenges. However, by working with third party intermediaries, a number of private equity houses are proving that it is possible to provide a commitment that maximises the value of their input in charitable initiatives, while minimising disruption.

A number of organisations operate mentoring programmes for people running charities and social organisations. PilotLight, as mentioned above, matches four-strong teams of business professionals with small charities seeking to move to the next phase of their development. The organisations provide a supportive framework for interaction (*see case study, page 76*), with dedicated project managers providing a conduit between the volunteers and the charity directors. The Kilfinan Group adopts a peer-to-peer model matching business people with the chief executives of charities, while Cranfield Trust has a national network of professional and financial services executives that provide pro bono consulting services to charities and social enterprises in areas such as business and strategic planning, budgeting and managing costs, marketing and communications, developing IT systems and human resources and staffing.

Likewise, organisations such as New Philanthropy Capital also act as intermediaries, matching those who are looking to provide time and money to help third sector organisations, with those organisations that will most benefit from that help (*see case study, page 68*). NPC helps groups to navigate the third sector, having created a process that identifies the most

effective organisations tackling particular social issues, producing independent research and analysis exploring the different approaches to a particular social issue, measuring the effectiveness of different organisations, gauging levels of government support, and identifying the third sector organisations that are positioned to make the greatest social impact. This service is provided on a bespoke basis, though the team has also produced a series of freely-available reports, mapping out a range of areas within the social landscape, to help guide donors in their decision-making processes.

The role of intermediaries is also paramount in terms of acting as a ‘cultural translator’, providing a way to gain knowledge and expertise, and to filter and direct the nature of engagement to maximise its impact. The models presented by the likes of the Private Equity Foundation, CAN Breakthrough and Impetus provide an opportunity for firms to commit varying degrees of resource, both in terms of capital and time.

There are a range of other organisations which help organisations to move towards building a programme of engagement (*see Figure 21 and Appendix 4 for additional case studies*). This includes organisations such as PhilanthropyUK, an online information resource for new and established philanthropists, and advisors such as Coutts, which help structure programmes and ensure that donors are giving effectively. Other organisations, such as the Institute for Philanthropy, provide a valuable resource for maximising individual and organisational philanthropic potential through training.

Figure 21

**Organisations to help structure a corporate philanthropy programme**

Stage	Example Organisations	Case Study
Initial information gathering	PhilanthropyUK	Appendix 1
Structuring approach	Coutts	Appendix 1
Training (becoming an effective philanthropist)	Institute for Philanthropy	Appendix 1
Selecting appropriate partner organisations	New Philanthropy Capital	Appendix 1
Selecting opportunities	nef	
Investing	Coutts	Appendix 1
Hand-on engagement	Pilot Light, Impetus, Joint ventures (e.g. Bridges, Breakthrough)	Chapter 4
Social Venture Funds	Unltd, Venturesome, Big Issue Invest, Launchpad, Triodos	Chapter 4

Working with organisations that have experience and credibility in the social sector also has advantages in terms of signalling a genuine commitment to the issues at hand. Given that philanthropy can be seen as a PR vehicle and that cynical initiatives in this vein rapidly become targets of negative media speculation, developing a coherent programme with the support of those already experienced in the field therefore provides a way to optimise success and avoid the charge.



The authors would like to thank the following organisations for their participation in the research for this report. In addition, we would like to thank all those BVCA members that completed the online survey.

3i

Abingworth Management

AccountAbility

Adventure Capital

Alchemy Partners

Andromeda

Apax Partners

Ashoka

Association of Charitable Foundations

Barclays Private Equity

Big Issue Invest

Blue Ridge Foundation

Bridges Community Ventures

Brightstation

CAN / Breakthrough

Carbon Trust

Centre for Venture Philanthropy

Charity Bank

Cinven

Climate Change Capital

Close Brothers Private Equity

Community Development Finance Association

Coutts Private Bank

David Carrington

Doughty Hanson & Co

East Side Consulting

ETF

European Venture Philanthropy Association

Foresight Ventures

Foursome

Good Capital

HgCapital

Impetus Trust

Index Ventures

Institute for Philanthropy

London Rebuilding Society

nef – New Economics Foundation

NESTA

New Philanthropy Capital

P3 Capital

PeaceDirect

Permira

PhilanthropyUK

Pilot Light

Platina Finance

Private Equity Foundation

Resonance

Silicon Valley Community Foundation

Sir Ronald Cohen

Social Finance

SVG Capital

Trapezia

Triodos Bank

Unlimited Ventures

Venturesome

WHEB Ventures

## **CASE STUDIES**

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## Chapter Two Case Studies Mainstream Private Equity

### Case Study Doughty Hanson

Doughty Hanson has begun to develop a comprehensive strategy in the area of Environmental, Social and Governance (ESG), which is in part driven by Nigel Doughty's personal interest in the area of sustainability, but also a growing interest in social and environmental responsibility amongst the firm's LP base: *'During our last fundraising in 2004-05, we were beginning to hear questions from our limited partners in relation to CSR and ESG. Some of the funds-of-funds, whose limited partners tend to be smaller endowments, government entities and pension funds, were also hearing the same from their own investors, who are naturally a step ahead when it comes to social responsibility issues,'* says Stephen Marquardt. The firm is seeking to institute a culture of sustainability and social responsibility across all three of its teams, which include Private Equity, Technology Ventures and Real Estate.

The firm's programme includes the following key strands:

#### a) The Doughty Hanson Charitable Foundation

The group's Charitable Foundation was created in 2000, and is administered by the Doughty Hanson team. The foundation is very much an employee driven programme, supporting the charitable causes championed by members of the team, although it also backs causes supported by the Doughty Hanson limited partners and portfolio. The foundation's mission is to support a range of causes including fighting poverty, disability and homelessness and promoting healthcare and education in all sections of society. *'We have had a charitable programme in place for around 7-8 years now, and we back around 40 projects a year. The projects might be located where our portfolio companies are based; they might come from suggestions within the team, or from our investor base,'* says Mark Florman. Doughty Hanson was also one of the founding partners behind the Private Equity Foundation (see case study, page 66).

#### b) Certified Carbon Neutral

Doughty Hanson has been working with the Carbon Trust to reduce its carbon footprint since 2006, and was certified carbon neutral early last year by The Carbon Neutral Company. In addition to this, the group's latest annual investor meeting was also a carbon neutral event, with the travel arrangements of LPs over the two-days assessed and offset.

#### c) CSR and Investment Strategy – United Nations Principles of Responsible Investment

Doughty Hanson was amongst the first private equity firms to sign up to the United Nations Principles of Responsible Investment (UNPRI), which commit signatories to addressing ESG issues as part of their investment selection and portfolio management processes. The team has tackled 'the easy stuff' first, integrating the products of its cleantech venture capital companies into other elements of the portfolio (i.e. buyout and real estate), and scrutinising the manufacturing practices of its investee companies: *'We backed Umbro in 2002 and they had manufacturers in the far east, which were not following good manufacturing and employment practices. We dealt with this swiftly, severed the relationships with the manufacturers that fell short of our ethical standards, bought in new suppliers, which were then monitored on an ongoing basis. We underwent the same process with Tumi, a luggage company that we acquired in 2004.'* Stephen Marquardt.

Ensuring that portfolio companies meet the required ESG standards simply makes good business sense in the current climate, according to Stephen Marquardt, *'if you want to sell your portfolio companies in three to five years time, you have to make them as attractive as possible to potential buyers. If you're selling to anyone in the FTSE 250, they have to tick the green and ethical boxes for their shareholders. It's soon going to be required business practice.'*

#### d) Supporter of Bridges Community Ventures

Doughty Hanson is an investor in Bridges Ventures, a venture capital firm with a social mission that invests in businesses in the most run-down parts of the country, or companies offering a strong intrinsic social return in sectors such as healthcare, education and the environment (see case study, page 55). The group also has a seat on the Bridges Ventures investment committee.

Doughty Hanson continues to roll out its commitment to environmental, social and governance issues and is in the process of recruiting a 'Sustainability Officer', who will sit within the private equity team. It also intends to extend its commitment to carbon neutrality across the entire portfolio. In terms of its philanthropic initiatives, the team is seeking to develop its approach, considering the possibility of providing not just capital, but time and resource to charitable organisations seeking strategic support.

## Case Study

### 3i

3i has arguably one of the most evolved approaches to corporate social responsibility of any European private equity firm, partially reflecting its listed status, but also its roots in post-war community regeneration: *'Given our history, local community involvement has always been a natural part of the 3i culture,'* says Patrick Dunne. 3i won the Investor Relations Society Best Practice Award in April 2007 and is listed as one of the 'Top 100 Companies that Count', which is Business In the Community's Corporate Responsibility Index. The BitC award recognised the firm's integration of CSR principals and related risk management processes into its core business.

The group's Corporate Responsibility Committee considers and reviews environmental, ethical and social issues relevant to the business and reports regularly to the board. The committee identifies and assesses the risks presented by social, ethical and environmental issues, using a risk-matrix methodology. The findings are recorded in a group-wide 'risk log', which monitors the management and mitigation of the risks identified, with significant issues reported at the Operational Risk Committee.

The group's commitment to CSR extends beyond the 3i organisation to its 750-strong portfolio, with environmental, social and ethical matters considered during the investment decision-making process: *'Our investment papers have a CSR section, where we check off whether there are any social, ethical or environmental issues with the company. Where there are issues, we undertake full due diligence to investigate them. These days, it is commercially imperative for a business to address issues relating to CSR. When it comes to exit, if a business has some horrible governance, environmental or ethical issues, then it can't be sold. It is the commercial interest of the investment that these issues are addressed. CSR is simply good business practice,'* says Patrick Dunne.

In terms of environmental sustainability, 3i measures the energy and resource used across its worldwide office network, setting targets for improvement. The group achieved a reduction in CO<sub>2</sub> emissions associated with its office accommodation of 26.6% in the two years to March 2007, and aims to become carbon neutral over the next three years, to March 2010. The group's procurement policies also favour suppliers that can demonstrate clear environmental advantages. Its performance in the area of sustainability is measured against the Dow Jones Sustainability World Index, which tracks the financial performance of leading companies in terms of corporate sustainability and of which 3i is a constituent.

3i's charitable activities reflect the group's community-based culture, backing initiatives such as Bridges Community Ventures (*see case study, page 55*), The Passage, a homeless charity operating in the vicinity of the Group's Victoria Office, and Business in the Community, which is a group of 800 UK companies that are committed to improving their positive impact on society. 3i has sought to institute its charitable programme across all levels of the organisation through its Give As You Earn scheme, which matches the donations given by UK staff and the proceeds of staff fundraising efforts.

As a founding sponsor of the European Venture Philanthropy Association, 3i's approach to its charity work shares many of the principles associated with the venture philanthropy model. It takes a longer-term commitment providing resource and skills, alongside capital, and supports the building of strong management capabilities in the charities it works with. It is over 30 years ago that 3i founded 'Business Dynamics', which is part of 'The Enterprise Education Trust', and seeks to introduce young people to the opportunities and challenges of business and improve their skills. Today almost 100,000 school children go through its programmes. *"On top of providing funding every year since formation, we have helped with branding and networking; a number of 3i people were involved."* says Patrick Dunne. Similarly, the group is involved with 'In Kind Direct' which redistributes products donated by manufacturers and retailers to third sector organisation; according to Patrick Dunne, 3i's involvement is far from arms-length, *"we have a guy from 3i on the fundraising committee; we helped them build their website and we provide support and strategic input."* Finally, many of 3i's team are trustees or chairman of charities. Dunne for example is Chairman of Leap Confronting conflict, the UK's leading organisation in helping young people deal with conflict. *"Working with CEO's to grow their organisations is natural for us and Leap's CEO has recently gained a tremendous amount from taking part in 'INSEAD Social Entrepreneurship Programme': 'There is a strong investment mentality in the private equity industry, and this includes backing talented individuals. So investing in leadership and backing vision and ambition forms part of this.'"* Patrick Dunne.

## Chapter Four Case Studies Social Investment

### Case Study

#### **Social Investment Bank**

The establishment of an independent Social Investment Bank (SIB) was a key recommendation of The Commission on Unclaimed Assets, which was set up in October 2005 to investigate how funds released from dormant bank accounts could best be used for the public benefit. The Commission concluded that, rather than funding additional intermediate providers of capital (i.e. capitalising one or more grant making foundations), money from dormant accounts could be used to capitalise a wholesaler of capital that, using a mix of its own capital and incentives, either government tax credits or guarantees, would connect the third sector to private capital and the capital markets through financial intermediaries. The Commission estimates that, with a capital base of £330 million from unclaimed assets provided over five years, the SIB can leverage in a further £700 million from other sources.

*“The Social Investment Bank would address the systemic shortage of capital for third sector organisations.”*

Sir Ronald Cohen

The third sector, which includes social enterprises, charities, community groups and other organisations with a social purpose, is made up of a few large institutions and a myriad of small, poorly-resourced organisations. The sector’s funding is highly concentrated with 70% of income going to the 2% of organisations with an income of £1 million or more while 56% of organisations in the sector have an income below £10,000 (NCVO, Voluntary Sector Almanac 2006). In this way it is reminiscent of the commercial sector in the 1960s and 1970s. Then, access to risk capital sowed the seeds of an enterprise culture that improved business competitiveness and delivered far better services to customers. Financial innovation created products that matched investor interest and business needs, deepening the available resources for innovation and growth.

While third sector organisations are widely regarded as being best placed to solve Britain’s social problems, they cannot currently access capital to develop stable revenues, innovate or scale. To improve the ability of the third sector to respond to society’s changing needs, it is necessary to affect a fundamental change to the third sector’s ability to access such capital. To improve efficiency, and give organisations greater flexibility, such capital should be repayable where circumstances permit. Grant funding is often highly restrictive, leaving little room for the organisation to adapt and change, or to invest in their workforce or infrastructure. In terms of accessing loan and commercial finance, social enterprises currently lag significantly behind other categories of SME.

The creation of a coherent capital market for the third sector is further complicated by the sheer diversity of organisations operating within the space, including charities with no trading revenue, social enterprises that re-invest some or all of their profits in their mission, and commercial, revenue-generating businesses with a social purpose. Furthermore, there is a range of legal forms that third sector organisations can take, requiring a variety of funding types and structures.

The SIB represents an opportunity to build vital investment infrastructure for a social marketplace that would support the whole spectrum of third sector organisations. This would require the blending of social expertise with high calibre corporate finance expertise to create new products and services that would benefit third sector organisations, attract mainstream investors and establish social investment as a professional asset class. In this way, the SIB would become a repository of experience in social investment in the UK, supporting greater innovation through financial research and product development.

The SIB board will combine professionals from the financial services sector, including the private equity industry, with the third sector, creating a blend of skills and experience. The main remit of the SIB would be to:

- i. Assist existing and new social financial intermediaries, including banks and funds providing loans and equity-like capital to third sector organisations, by supporting their efforts to raise private capital and financial product innovation.
- ii. Create market demand by increasing the availability of financial advice and corporate finance services for third sector organisations seeking investment.
- iii. Develop programmes of sustained investment in third sector organisations in specific markets such as community regeneration and financial inclusion.
- iv. Fill gaps in the marketplace where a lack of appropriate capital is restricting social impact.

Social Finance is a new organisation that aims to lay the foundations for the SIB. Prior to receipt of capital from dormant accounts, it will demonstrate the need and potential of the SIB, and build the expertise needed to run it.

## Case Study Bridges Ventures

Bridges Ventures, a venture capital company with a social mission, was launched in 2002 to deliver attractive returns to its investors, while also making a positive social or environmental impact. Bridges' funds aim to put the skills and experience of private sector venture capital to work to help deliver economic and social regeneration in some of the most run-down parts of the country or in businesses offering a strong intrinsic social return. The success of Bridges second fund, CDV II, which closed on £75m in June 2007, indicates the growing popularity of social investment among private investors.

Bridges Ventures was set up on the back of the Social Investment Taskforce's recommendations, which reported to the Chancellor of the Exchequer in 2000. Bridges Ventures was founded by Apax Partners, 3i and entrepreneur Tom Singh, with Doughty Hanson now also involved and Nigel Doughty on the Bridges Ventures board. Michele Giddens, a Director of Bridges Ventures, recognizes the value of the private equity founders' support: *'Bridges was enormously assisted by the backing of Apax, 3i and Doughty Hanson. We draw on our private equity partners for advice on new investments, for non-executive directors and access to their networks. In return, they also benefit greatly. We present to their teams and their staff are highly engaged and interested in what we're doing and it is certainly a positive motivating factor for them.'*

While all Bridges Ventures' investments must meet strict economic and social criteria, they are equally focused on achieving the maximum financial return for their investors. For each investment they closely examine the market, establishing both a financial performance track record and a measurable social return, to give investors the necessary tools to make informed decisions.

Bridges Ventures, with their unique social investment model, were supported by the government for their first fund, CDV Fund I. The government's investment of £20m on a 'subordinated basis' was matched by £20m of private investment. Bridges' second fund, Bridges CDV Fund II, raised 75m, beating their original target by 50%. The fund, which was oversubscribed, was raised entirely from the private sector, attracting a range of investors, including private equity firms, banks, university endowments and local authority pension funds.

All of the first fund, and 75% of the second fund is invested in the most deprived 25 % of the country as defined by the Index of Multiple Deprivation. The remaining 25% of the second fund is available for investment in businesses that can show strong social benefit in areas such as healthcare, education the environment and ethical business.

To date, the firm has invested in 33 companies including SimplySwitch, a price comparison website, School Stickers, a provider of motivational stickers for teachers and The Office, which renovates old freehold properties in inner city areas to create flexible office space for small businesses. Fund I has achieved three successful exits to date, achieving IRRs of 29%, 84% and 165%. Bridges' social impact is clearly evident, with their companies employing 830 people, nearly 200 of whom came from long term unemployment.

While the Community Development Venture Capital (CDVC) model is well established in the US, with more than 60 such funds backing businesses in economically distressed areas, Bridges Ventures is the largest of its type globally. It is in discussions with a number of managers in the UK and Europe who are exploring the potential for setting up similar funds elsewhere.

Bridges Ventures recently established an advisory board to help Bridges with strategic issues as well as providing a forum for social investment more generally. The board includes a number of leading figures from the worlds of private equity, business, banking and asset management. Michele Giddens commented: *"we hope that the fact that high profile individuals are engaging directly with our work suggests a growing interest in private sector social investment"*.

Bridges Ventures' success highlights the market potential for similar CDVC funds in the UK. Support from the private equity industry is vital in making this happen, providing a key source of catalytic capital, skills and expertise.

## Case Study

### Triodos Venture Capital Deal: Aarstiderne A/S

Investor:	Triodos Venture Capital Fund B.V.
Location:	Barrit, Denmark
Development Stage:	Expansion
Date of investment:	9 July 2001 - 20 February 2006
Type of holding:	Ordinary shares (incl. a convertible loan that converted in 2004)
IRR at exit	15%

**Introduction.** Organic farm shops and box schemes now seem run of the mill with mainstream supermarkets launching organic produce schemes. However, when Aarstiderne was founded in 1999 this wasn't the case. Thomas Harttung founded the company with a Danish celebrity chef with the aim of "bridging the farm to the kitchen" or linking the consumer with the provenance of his food.

**The investment.** Aarstiderne became a well-known Danish internet based food and retail brand and, after growing to around €4.1m turnover in 2000, looked to secure investment to underpin the rapid growth of the business. In July 2001, Triodos Venture Capital Fund invested €1.5m to boost working capital, upgrade IT and finance systems and hire new staff. As a part of the investment, a further €750,000 loan was made available to the company. From 2000 to 2005, the company's turnover grew from €4.1m to €20m. This growth was enabled by restructuring the company's operations, the strengthening of the senior management team, and the company's strategy to further strengthen its brand by producing organic produce itself. In 2006, Triodos sold its stake back to the founders ensuring an IRR for Triodos of 15%. This buyback mechanism was agreed at the time of the investment as it was the founder's preference to have the option to re-purchase full control of the business.

**Triodos involvement.** Reasons Aarstiderne chose to partner with Triodos:

- Ethos: It was important for Aarstiderne to partner with the right organisation and given Triodos' purely social and environmental remit, it was a natural fit;
- Triodos' specific knowledge of the organic sector having been a leader in financing organic farms and having invested in other organic food businesses;
- Triodos' longer term horizon and its desire to work collaboratively with management to help them achieve their goals;
- Meeting of minds between the Triodos investment executive and the founder; and
- The speed with which Triodos assessed the opportunity including the due diligence.

**Key success factors:** The shared vision between the founder and Triodos of the changes necessary in the business in order to keep pace with the anticipated growth; the strengthening of the senior management team; holding on to the vision of being a customer focused business and enhancing the professionalism of the company; and the shared vision of developing a transparent corporate culture and of striving for success over the long term, rather than focusing on the short term.

**Aastiderne's viewpoint:** Words from the founder, Thomas Harttung

*"The Triodos Venture Capital Fund's role as an investor in Aarstiderne from 2001 till 2006 has been an absolutely crucial element in the company's success so far. ... The 2001 Transaction was designed to be fair and robust from both an investor and investee perspective. ... Triodos's broad-based involvement in and understanding of the European organic food sector has been a unique asset in the partnership. ... In retrospect the agreed buy-back element was also a key success factor. It guaranteed that there were no hidden agendas from either side. As an entrepreneur raising capital, one of the most difficult elements to safeguard is the long term integrity and destiny of the business one has founded."*



## Case Study Good Capital

Good Capital is a US-based investment firm that is in the process of raising the country's first institutional fund targeting the social enterprise space. Its pioneering 'Social Enterprise Expansion Fund' (SEEF) is seeking to raise \$30m for investment in for profit and not for profit social enterprises with high growth potential and strong management team. The founders see strong demand for growth capital within the social enterprise space, which is not being met by traditional mission-related grant funding or commercial debt and equity finance: *'There is a systemic issue in the market, which makes it difficult for social enterprises to reach their full potential. Social enterprises tend not to have an asset base against which to secure a loan, and grant funding is more focused on proof of concept, which is not appropriate for businesses looking to make a step change,'* says co-founder, Kevin Jones.

SEEF will invest in later stage growth situations, providing a mixture of equity and structured venture debt, with an average investment size of \$1-3m. The team has identified an initial pipeline of 30 investment opportunities, from an initial pool of 125, representing a total capital need of \$130m. Of these, the fund will seek to fund between 10-12. An example of a likely early investment is in Betterworld Books, an online retail business that sources and re-sells used books from university campuses and libraries, donating 5% of the profits to worldwide literacy projects. The company has grown from 3 to 130 employees since its inception in 2003, and generates \$18m in revenues.

The Good Capital team has a mix of skills, with Tim Freundlich, a transactional specialist within the social capital markets, Kevin Jones, a serial entrepreneur and founder of a number of social enterprises, and Joy Anderson, who has experience working both with social ventures and with members of the institutional and philanthropic community. *'You have to be multi-lingual in our sector, as there are so many different languages at play. We have a good blend of skills and experience; I can sit down with a social entrepreneur and speak their language, we have a transactional specialist from within the social sector, and Joy, who speaks the language of our investors.'* Kevin Jones.

Investors in SEEF include high net worth individuals and smaller family foundations, where it is easier to navigate around organisational barriers between investment and philanthropic decision making. According to Jones, the fundraising has been challenging, *'it is a harder product to sell compared with a straightforward commercial or philanthropic venture. You are dealing with two different departments, two different streams of thought and two sets of motivations, which need to collaborate to make a decision. We are not going to attract investors that think in a very binary way, with one pocket focused on investment and the other on charitable giving.'*

The fund is targeting full recovery of capital and a positive IRR, which enables philanthropic investors to make their commitments more sustainable, and offers charitable foundations the opportunity to better align their core investment strategies with their social mission. However, Jones has found that, *'there is no proven sales method with the fund, though we tend to lead with the social mission, which is the most important element, and highlight the financial return as an additional benefit. It is effectively a more powerful way of giving.'*

The experiences of Good Capital provide important learnings for the UK social enterprise sector, where a number of organisations have begun to explore the opportunities for new forms of funding, including groups like Big Issue Invest, Unltd Ventures and Venturesome. Indeed, the UK Government's Office of the Third Sector is currently engaged in a consultation to explore the potential for creating a £10m risk capital fund for social ventures, an initiative that was first proposed as part of the Social Enterprise Action Plan in 2006.

## Social Venture Funds

The social venturing community has been vocal in declaring the potential benefits that engaging with private equity could bring. The following case studies provide an introduction to some of the top funds in the UK, many of which are in the process of raising new capital, sourcing new deals, and expanding their non-financial support networks, and are therefore keen to engage with private equity houses.

From financial modelling through to strategy development, management expertise and access to networks, the funds mentioned below all have individual requirements which private equity professionals could help to meet. The funds highlighted include organisations adopting a variety of approaches to funding third sector organisations, including providing grant, debt/mezzanine and equity funding to assist charities and social enterprises alongside direct 'hands-on' support.

### Launchpad

Launchpad develops promising ideas into new ventures by providing funding, social capital and entrepreneurial expertise. Its early stage social venture funds seek to achieve social impact by supporting ventures that are innovative, sustainable and scalable. Currently with two active funds, the NESTA-Young Foundation Health Innovation Accelerator (health and long term conditions) and Learning Launchpad (education and practical learning), Launchpad's vision includes additional early stage funds focussed on areas such as sustainability, innovation and justice and the hard to employ.

Launchpad supports external entrepreneurs and ventures at their earliest stage, as well as developing ideas internally. Part of the Young Foundation, it utilises current research, its network and frontline experience with practical work to identify unmet social needs. Launchpad's staged venture capital style process allows for ideas to be fully designed, developed, piloted and launched. This includes providing both funding (grants, loans, equity) and intensive non-financial support (hands-on engagement, network) to new ventures. An 'inside-outside' organisation, Launchpad leverages its connections with government, the public sector and industry to facilitate the growth of new organisations, whilst remaining sufficiently independent to ensure flexibility and innovation particularly across public sector boundaries.

Launchpad builds on the work of Michael Young, one of the most influential social thinkers and social entrepreneurs of the 20th century, who was involved in creating more than 60 new ventures, including the Open University, Consumers Association, Education Extra, International Alert and the Economic and Social Research Council, as well as precursors to NHS Direct and the Expert Patients Programme.

*'Venture capital and private equity engagement would be very valuable to us both in terms of investment expertise as well as management and growth of new ventures. Executive and non-executive skills and engagement with our ventures would help combine business acumen with social purpose.'*

Simon Tucker, Head of Launchpad

### Venturesome

Venturesome provides mezzanine loans and investment, to assist charities and social enterprises in instances where requirements are too risky for a bank loan or outside the criteria of a grant-maker. Venturesome's strategic goal is to create a lending environment for charities of different risk profiles ranging from low risk bridge loans, to high risk open development capital. Support might take the form of underwriting, unsecured loans or equity-type investments, and can be used to fund working capital, development capital, and as bridge financing for capital projects. Venturesome seeks to recycle funds with each loan custom-built to fit with the needs of a charity, and with a view to loans being repaid over time. Venturesome is funded by grant-making trusts and private individuals.

*'Having private equity expertise on our investment committee would be highly valuable.'*

John Kingston, Director

### **UnLtd Ventures**

UnLtd Ventures is the in-house consultancy division of UnLtd. It provides business support to a number of social entrepreneurs, helping them to scale up or replicate their organisations. These individuals have already established successful social ventures with innovative solutions that meet society's challenges.

UnLtd Ventures provides hands-on advice and support with strategy development, business and financial management, replication/growth models, organisational structure and governance, etc. This support is provided through its own in-house team of consultants and experienced practitioners, as well as through an exclusive group of industry specialists and partnerships with external providers.

UnLtd Ventures has recognised that a lack of financing often holds back early-stage social enterprises from growing to scale and achieving their full potential. Where appropriate, UnLtd Ventures acts as a broker between clients and providers of a range of different types of funding. Sarah Dodds, Director of Ventures, notes: *'It would be incredibly valuable to be able to tap into the skills of the VC in a creative sense, to get some experienced heads together to work out these problems and come up with some interesting and creative solutions. I feel that the social enterprise space is like the VC industry was in the 1970s and 1980s.'*

### **Adventure Capital Fund**

The Adventure Capital Fund backs established community enterprises with a mixture of loans and grants, as well as expert support. It currently has 3 investment funds:

- The Main Investment Fund provides established community enterprises with working capital, asset purchase or refurbishment funding. ACF provides a mix of loans and grants totalling £50,000 to £750,000, along with a comprehensive package of support.
- The Managed Workspace Fund provides investments in the form of both loans and grants to community enterprises looking to set up a managed workspace facility. These workspaces will be rented to a vibrant mix of third sector organisations and other businesses. The Managed Workspace Fund's aim is to help investees achieve financial sustainability for themselves: the host organisation will receive a sustainable income stream through the rent paid by its tenants, while the workspace will offer tenants a supportive environment in which they can develop.
- The Business Development Fund is for community enterprises in the early stages of development. A grant of up to £15,000 comes with five days' support and can be used to develop an organisation's skills and capacity, making it ready to run its own enterprise and trading activities.

ACF expects both financial and social returns on its investment, and reports dividends on both metrics to investors.

*'I'd be happy to work with venture capital and private equity investors, putting their investment and financial management skills to work.'*

Sue Peters, MD, Investments

### **Big Issue Invest**

Big Issue Invest is a specialised provider of finance to social enterprises. Part of The Big Issue group of companies, it is led by social entrepreneurs and staffed by social financiers. Big Issue Invest is a social enterprise, with an asset lock and any dividends paid to The Big Issue.

Big Issue Invest can creatively analyse social enterprises, and is prepared to think beyond the traditional measures of company accounts and asset valuations, to design financial solutions suitable to the enterprise. Financial structures include asset and cash flow backed senior debt, as well as cocktail financing that may include royalties, loan conversion and guarantees. Each loan is tailored to each enterprise's stage of development and risk profile, as well as being focussed on scale-up.

The average size of Big Issue Invest's loans is around £200,000. The minimum loan size is £50,000. Big Issue Invest has also put packages together with other social finance institutions for over £500,000.

*"We want people to 'invest' rather than make a 'donation', so we can prove to them that year after year we can generate both a financial and social return."*

Nigel Kershaw, Chief Executive

### **Triodos Bank**

Triodos Bank finances companies, institutions and projects that add cultural value and benefit people and the environment, with the support of depositors and investors who want to encourage corporate social responsibility and a sustainable society. Offering personal banking, business and charity banking and investment banking services, Triodos offers a full range of social banking to organisations that value people and the planet, as well as profit.

Since 2001, Triodos Bank has raised two venture capital funds totalling €75 million investing equity in social and environmental enterprises across Europe. The most recent, the Triodos Innovation Fund, is building a portfolio, which includes investments needing early-stage and expansion capital. The Fund is well positioned to tap Triodos Bank's wide network of social and environmental enterprises. It considers investments from £250,000 to £2 million per company.

*"There is limited awareness within the private equity and venture capital industry of what social venture capital is. People understand philanthropy on the one hand and financial investment on the other, but many struggle with the concept of social investment. Yet it is possible to invest venture capital and achieve social, as well as financial returns. Our investment in an IT business that establishes supply chain transparency is case and point. The ability to establish chain of custody in a scaleable manner means brands can no longer plead ignorance about who their suppliers are."*

Whitni Thomas, Investment Manager

### **London Rebuilding Society**

London Rebuilding Society is a Community Development Finance Institution, which specialises in developing innovative forms of finance to make loans to social enterprises that help the most socially deprived, financially excluded and hardest to reach communities in the Greater London area. Via this method, it aims to regenerate and develop communities by injecting cash into one part of a local economy so that a domino effect is produced eventually leading to the benefit of the whole community. The average loan size invested is £30,000 to £35,000.

London Rebuilding Society also provides a range of customised training programmes, workshops and one-to-one coaching to help social entrepreneurs and their advisers with business support functions.

*"We provide support to businesses in terms of putting together their business plans so that they are investment ready. However, we are limited in the levels of support we can provide post-investment. We don't do as much as we'd like. It would be very interesting to tap into the venture philanthropy world to leverage their skills. If we could get the venture philanthropy community to invest in community finance, then we could engage their skills and provide more than capital. If we could use their hands on experience it would be highly beneficial for our enterprises."*

Naomi Kingsley, Founder and Chief Executive

### **Resonance**

Resonance focuses on assisting social enterprises in their strategies and matching them with investors of all sizes who desire to invest in sustainable, well-planned, values based projects. Passionate in its mission to mobilise risk capital with values, Resonance helps investors and social enterprises to articulate what their individual blend of values are. Resonance is able to help social enterprises 'in getting investment ready', raising appropriate finance and post investment project management. Such services are provided either in combination or in isolation of each other.

*'VCs may begin to look at the social sector and express a desire to get involved and lend their expertise and skills in return for the social benefits. They could give us their criteria, cleantech for example, and we could come up with exciting opportunities, and give them the opportunity to provide the last 25% of the deal value plus their skills.'*

Daniel Brewer, Founder Director

### **Breakthrough**

See case study, page 62.

## Chapter 5 Case Studies High Engagement & Venture Philanthropy

### Case Study LDC

Asking your colleagues to devote time, effort and money to charitable causes can result in a number of interesting reactions. This is especially the case when the individuals at the company work very long hours, spend time away from their families and partners on a regular basis, and have little time to focus on activities outside their perceived sphere of influence.

But following the Indian Ocean earthquake tragedy in December 2004 that's just what LDC did. *"Our culture is built around a number of strong cultural themes - teamwork, camaraderie, partnership, professional integrity and community support. As an organisation LDC has always made charitable donations, but the tsunami disaster acted as a catalyst for our organisation to do something bigger. Identifying the route our organisation should take was the next step"*, says Rob Pendleton

Following the tsunami several staff travelled to one of the worst affected areas of Sri Lanka and spent two weeks helping the local community repair buildings and build a community vegetable garden.

It was from this that the 'LDC in the Community' concept was developed; an approach that has become an integral part of the LDC organisation. *'There was a firm-wide desire to create an organisation to be proud of'*, says Rob Pendleton.

The 'LDC in the Community' initiative provides an overarching catchall for the charitable work that goes on across its national and regional networks. The team raised over £300,000 last year, compared with just £30,000 three years ago, *'it really is part of the heart and culture of our organisation. It's not about ticking the CSR box. We do this because it's the right thing to do, and because we want to'*, says Rob Pendleton. It also goes to illustrate how much more effective a team can be when philanthropy is instituted at a firm-level, providing a framework for engagement across all levels of a team.

The capital from the 'LDC in the Community' programme is distributed amongst a number of national and regional charities and is derived from the team's fundraising efforts in addition to a portion of LDC's profits. Each LDC local office champions its own causes, and this matches the regional culture of the organisation. This cultural resonance is important, and serves to match the skills and values of an organisation, and its employees, with its charitable work. For instance, LDC in the North supports Hollybank Trust, a charity supporting children with complex disabilities, raising funds during 2007 with its 'Team Bacon Buttie' in the Circuit Driver Caterham Academy Championship racing events. In the South, the team supports Camp Mohawk, a summer camp for children with autism, raising over £13,000 in 2006 and in spring 2007 the LDC staff and other individuals from the local business community spent a day preparing the camp for summer. The whole LDC team also comes together to get involved in company-wide initiatives, including the annual LDC charity quiz, which takes place across six venues simultaneously with 140 teams taking part and the London Marathon, with 40 individuals from across the group currently in training for the 2008 event.

## Case Study Breakthrough

Breakthrough is an initiative that was created through collaboration between CAN and Permira, and was launched in 2005. The initiative was created in response to a desire amongst the Permira partners to explore ways to evolve their group-wide approach to philanthropy. While the team, both as individuals and as a firm, were active supporters of a number of social causes, this was happening in a fairly informal, ad hoc manner. The partners decided that they wanted to do something that matched the culture of the firm and provided the opportunity for team-wide involvement. They were looking for a way to apply the skills employed in their day jobs with the challenges of the social sector. It was, however, a difficult task to find the right vehicle. Adele Blakebrough, Chief Executive of CAN, recalls the team's dilemma, *'They had found a range of the usual charities, The Princes Trust, Save the Children for instance, but they were looking for something more engaged, something linked to their day-to-day world.'* As such, the team decided to explore the opportunities for creating their own initiative in the social enterprise space, choosing to go down the joint venture route, and identify an organisation that was well established in the third sector community to partner with.

In the meantime, Adele was already grappling with some of the systemic issues in her own sector and had growing concerns over the market failures that she was observing within the charitable world, *'I was noticing that some great projects were getting stuck, even though they were achieving some good results. You don't see this in the private sector, where good companies grow. It raises the question of why success doesn't seem to breed success in the charitable sector.'*

There were obvious synergies between Permira and CAN, in terms of their shared vision for supporting interesting, high-impact organisations to achieve their growth potential, which made for a strong partnership. *'Permira liked our entrepreneurial style, which was a good match with their approach and vision,'* recalls Adele. Permira initially invested Euro 1m in the Breakthrough fund, to be committed over two years, while team resource was also made available, with a Permira executive allocated to each organisation supported. Benoit Vauchy, a Permira executive, works with one of the initiative's social enterprises. *'I'm involved on the financial side, banking, cash flow planning, which is always a challenge for these businesses. I'm also involved in growth planning, coaching and supporting management. It's not that different to the role we play with our own portfolio,'* says Benoit. However, according to Benoit, partnering with a social entrepreneur requires mutual respect and patience, *'There is something of a cultural divide, and there is a danger that private equity people will go in and start telling the entrepreneur how to do his job. It has certainly been a two-way learning experience and business people, who are focused on commercial returns, will find it hard when a social enterprise ends up burning money in order to optimise the social return. Also, social entrepreneurs are passionate and driven and tend to be big characters, which means you have to be very careful when it comes to building the relationship.'* Overall, Benoit has really valued the experience of working with a social enterprise, *'Being given the opportunity to spend time and money on a social enterprise is very positive indeed. I feel like I've been given a great opportunity, it's a gift. I get to meet interesting people and I've learnt valuable lessons about motivation and drive from the CEOs I've worked with. The main benefits from my perspective are in terms of personal enrichment and satisfaction. It makes me feel that I'm involved in something more than just making money.'*

The first Breakthrough fund was initially set up to pilot the idea, with a view to launching a successor vehicle if the model proved viable. Five organisations have been supported to date: FareShare ([www.fareshare.org.uk](http://www.fareshare.org.uk)), Law For All ([www.lawforall.org](http://www.lawforall.org)), Training For Life ([www.trainingforlife.org](http://www.trainingforlife.org)), Green-Works ([www.green-works.co.uk](http://www.green-works.co.uk)) and TimeBank ([www.timebank.org.uk](http://www.timebank.org.uk)). Since Breakthrough's involvement, these organisations have seen their revenues rise by 20% and their social impact grow by 40%. On the back of this success, the CAN team is on the fundraising trail with its second fund, seeking to raise further capital from a range of financial and professional services organisations. Permira will continue to support the initiative with both capital and resource.

## Case Study

### **The ERM Foundation Low Carbon Enterprise Fund / Bridgepoint**

Bridgepoint-backed environmental consulting firm, ERM, is in the process of launching a 'Low Carbon Enterprise Fund', which is seeking to invest in entrepreneurs and businesses in the developing world that reduce global carbon emissions and support local livelihoods. The fund is an initiative of the ERM Foundation, a UK registered charity and the not-for-profit arm of ERM, which has supported social and environmental projects for the past twelve years. The Foundation is led by ERM employees who volunteer their time and expertise. ERM is donating an annual monetary offset equivalent of \$200k to meet the fund's administrative costs, and support the pro-bono work of its staff.

The fund follows on from a successful \$600k pilot vehicle, which was launched to test the concept, and has backed five emerging market enterprises, including: a solar powered torch business in Nepal; a village bio-mass powered electricity generation enterprise in India; and an ecotourism enterprise whose revenues support the conservation of the Iwokrama rainforest in Guyana.

Bridgepoint is providing a cornerstone investment to the Low Carbon Enterprise Fund, and is lending additional support in the form of marketing and communications expertise, as well as opening up its networks to the ERM team. The Low Carbon Enterprise Fund is seeking to raise a total of \$2m, potentially providing an environmental and sustainable investment opportunity for other interested parties within the private equity industry. Emma Caddy, the director in charge of ERM's Low Carbon Initiative, is coordinating the fundraising process: *'The growing global threat of climate change demands innovation in the business sector. In the developing world, small businesses play a key role in influencing local communities to adopt and disseminate green technologies or conservation-friendly practices. ERM's Low Carbon Venture Fund will provide much-needed finance to ensure that these undercapitalized entrepreneurs can realize their full potential.'*

Along with the Breakthrough initiative between Permira and CAN (see case study, page 62), the Low Carbon Enterprise Fund provides an excellent example of a private equity house supporting a specialist to tackle an environmental or social problem. Bridgepoint had been seeking to quantify the social and environmental impact of its organisation as part of its CSR strategy, and the Low Carbon Enterprise Fund offered an excellent opportunity for the team to invest in a highly sustainable initiative that was supporting entrepreneurial low carbon businesses; overall a good strategic fit for the firm. *'The launch of the Low Carbon Enterprise Fund coincided with our own examination of our carbon footprint, and offered a more effective way to invest in reducing global carbon emissions. It really provided us with a sustainable alternative to traditional carbon offsetting,'* says James Murray of Bridgepoint.

The Low Carbon Enterprise Fund will seek to invest mainly loans, and some equity, in between ten and twenty emerging markets businesses, creating a sustainable pool of capital, with all returns to be re-invested in further projects. By recycling the capital invested, the fund provides a highly effective means for investing organisations or individuals to optimise their overall environmental return on investment, and to reduce the overall global carbon footprint. The fund is also highly transparent, providing quarterly updates on the benefits accrued by the fund and the new investments under consideration by the fund's directors and even offering backers the opportunity to co-invest on specific ventures.

Investors in the Low Carbon Enterprise Fund will have the opportunity not only to provide capital, but also resource and skills, with the ERM team encouraging contributors to provide advice, partnerships, business planning skills and entrepreneurial coaching support on a pro bono basis.

## Case Study

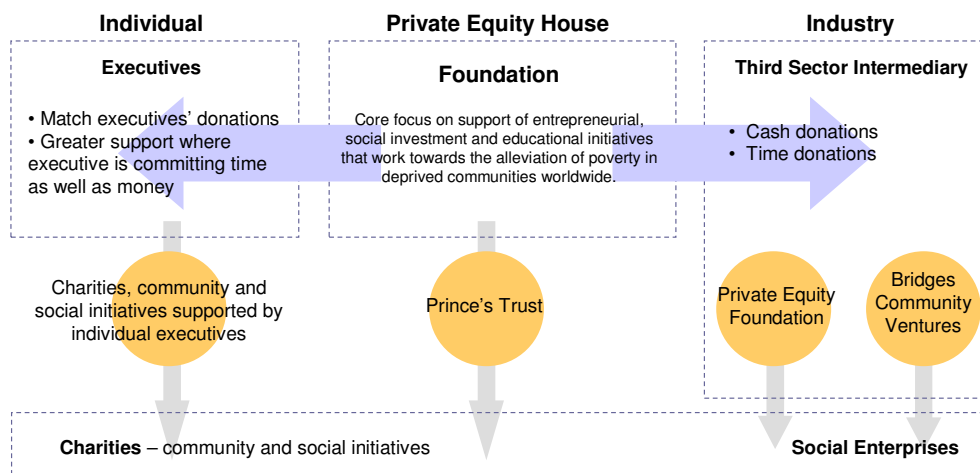
### The Apax Foundation

Apax Partners' approach to corporate philanthropy provides an example of how individual employees' own personal charitable activities can be integrated within an evolving corporate programme. As an organisation, Apax currently supports charitable and philanthropic giving at the level of the individual employee, the firm (via the Apax Foundation), and is also active within industry initiatives (such as the Private Equity Foundation). This includes support in the form of both time and money.

Peter Englander comments that this approach reflects the stage that private equity has reached in its own development, and its potential to meet third sector needs: *'What is currently occurring is a natural evolution within the industry. This is the way in which outside communities are expecting businesses to behave. ... Quoted businesses are devoting a lot of effort to CSR and charities, and we need to follow suit and realise our role in the 'community.'*

The Apax Foundation was established as a conduit for both individual executives to become more engaged philanthropically, and for Apax as an organisation to also do so. Alongside direct involvement in third sector organisations, such as The Prince's Trust, the Foundation therefore also supports employees' own initiatives through a 'matched funding' scheme, whereby personal money committed by executives to charitable causes is matched on a 2:1 basis by the Foundation; support may also increase if the employee has a direct (time commitment) relationship with the supported organisation.

At an industry level, alongside a commitment to the PEF, Apax has also been deeply involved in Bridges Community Ventures. Alongside the provision of funds (both to support Bridges' fundraising and strategic development), Apax employees have been directly involved; Englander sits on the advisory board, and Sir Ronald Cohen remains the Chair, a role he also held while at Apax.



The initiatives supported by the Apax Foundation also include those with a particular focus on issues that resonate with private equity and the firm's own approach. Bridges perhaps provides the clearest example of an organisation directly applying a private equity style approach to community redevelopment. However, the Apax Foundation's involvement with the Prince's Trust also includes a particular interest in supporting young entrepreneurs, for example, through The Prince's Trust Business Programme.



## Case Study Impetus Trust

Impetus Trust is an organisation whose profile within the private equity industry is growing, with many firms naturally attracted by its approach to philanthropy, which draws strongly on the private equity model. Indeed, Impetus was the first 'venture philanthropy' organisation to be established in the UK and was set up by private equity executive, Stephen Dawson and entrepreneur, Nat Sloane in 2002. The Impetus approach seeks to apply venture capital and business frameworks to the not for profit sector, working with small and medium sized UK charities that are seeking to make a step change in their impact. Impetus provides these organisations with strategic funding, expertise and capacity building support over a defined period of time, usually between three and five years, in order to help them to maximize their social impact.

Stephen Dawson had a personal interest in the charity sector, having been a volunteer in developing countries after he left University. However, building a career in the venture capital industry left little time for developing this interest. It was some years later, when Stephen had more time and money for a more active engagement in the charities sector, that the idea for Impetus came about, 'I talked to a number of people within the charity sector, and the message came back that there was a real need for longer term funding, assistance with building the core infrastructure necessary to support a growth strategy, and business expertise.' Around the same time, Stephen became aware of the 'venture philanthropy' model in the US and the fact that nobody was doing anything similar in the UK, *'the language being used was familiar – people were talking about exits and hands-on relationships for instance,'* says Stephen. The clincher was when he met with a group of 15 other people who were interested in the area, *'they represented pretty much everyone in the UK with an interest in venture philanthropy. There was a feeling that someone should do something, and I later discovered that Nat Sloane had very similar ideas to my own, so we became partners.'*

The Impetus approach incorporates many of the processes and techniques of private equity, starting with rigorous screening and due diligence to identify suitable charities, targeting not for profits with strong and ambitious management teams with a vision for taking their organizations to the next phase of their development. The team then makes a thorough assessment of how it can help to build the infrastructure and business skills that drive the charity's core activity: *'this might be to develop the management team, work through a growth strategy, fundraising strategy and processes, trustee skills, IT systems or brand building. It also might involve working with a social enterprise aspect of an organization, assisting with marketing strategy, pricing policy or management development for instance.'* says Stephen. Impetus has a number of professional corporate partners, which provide services such as due diligence and consultancy, which charities are able to tap into, *'our charities have found that the due diligence process adds a lot of value, and is much more than a box-ticking exercise. This is particular true in the case of commercial due diligence, where the idea of 'markets' and 'competitors' might not seem natural to the management team. People don't often consider trends in funding sources, for example, but it can be very instructive,'* says Stephen.

Investment is principally in the form of grant funding, although in a minority of situations, a more equity-like structure may be used if trading revenue is being generated, for instance, so that a proportion of the capital can be repaid and recycled. Impetus is highly results-focused, with each of its charities accountable for their performance. The team works with each organization to set specific goals, milestones and other mutually agreed benchmarks, providing them with the necessary framework to ensure they reach their targets by the end of their involvement with Impetus.

Impetus produces an 'impact report' monitoring the progress of its portfolio, and as of July 2007, investee organization had achieved income growth of 20%, compared with a market average of around 4% for the charitable sector as a whole. The number of people helped had increased by an even more impressive 50% a year. Over the last two years Impetus has been pushing a "leverage" model and, for every £1 invested by Impetus donors, the charities have received £6.50 in total benefits, which includes co-investment, professional services and expertise.

While Impetus has made some good early progress, Stephen feels that much more could be done in the sector, *'organisations like Impetus, Breakthrough and Private Equity Foundation are scratching the surface in terms of meeting demand, so we are keen to grow and keen to work with anyone new to the charity sector wishing to try out different models.'*

## Case Study

### Ashoka

Ashoka is a global fellowship of the world's leading social entrepreneurs recognised for creating innovative solutions to social problems. Ashoka fellows are elected after undergoing a rigorous selection process. In this they must demonstrate that they fully meet Ashoka's criteria ranging from creativity to the social impact of the idea. Having invested in more than 1800 leading social entrepreneurs in over 60 countries Ashoka have set up a 'Venture Fund' created to help increase the number of fellows it elects globally each year.

Ashoka is also collaborative in the world of social venture funds. In partnership with the International Agency for the Prevention of Blindness and Deutsche Bank, for example, they set up the Eye Fund – for the development of sustainable eye care. Delivering both financial and social returns, the fund aims to reduce blindness and visual disability across the whole societal spectrum whilst providing investors with 6% return per annum paid on a quarterly basis with principal repayment after 7 years. The funds estimated size is US\$50M.

## Case Study

### The Private Equity Foundation

The Private Equity Foundation (PEF) was created by a group of European private equity firms in 2006, and is an industry-wide philanthropic organisation seeking to 'apply private equity to charity' to create value and boost the social impact of the organisations it supports. The PEF is the first industry-level philanthropic initiative for the European private equity industry and was seen by its founders as an opportunity to create a framework for giving in a more effective manner. Being active philanthropists themselves, the founders of the PEF had first hand experience of the difficulties associated with differentiating between charities and in measuring the effectiveness of support provided. Taking the methods of private equity as a starting point, and adapting these to the non-profit sector is a logical approach: *'private equity executives are part of a new breed of philanthropists who are much more engaged with processes such as due diligence and market analysis. This is part of the private equity mindset and therefore something they naturally apply to their philanthropic activities,'* says Shaks Ghosh, CEO of the PEF. However, while the principles of private equity may be transferable, the context of the non-profit sector can differ and the model needs to be flexible, *'the business and charitable worlds speak in different languages, so it is not always easy to get them to talk to one another.'* The recent appointment of Shaks, who has a long and successful track record in the non-profit sector, most recently as the head of Crisis, is a key element in building an effective dialogue between the private equity and non-profit sectors.

The remit of the PEF was initially quite broad, targeting charities serving children, community support and education. Part of Shaks' mission has been to articulate a more focused remit for PEF, building on the notion that the European economy is in transition and that this new phase, characterized by globalisation and a shift towards a knowledge- and service-based industries, has unintended consequences for some people. According to Shaks, predictions suggest that there are five million unskilled jobs in Britain, with the market for such jobs expected to shrink to 500,000 in the next five years. In addition, there are thought to be 1.5 million NEETs (not in education, employment or training) in the UK, a figure that will continue to grow as the unskilled sector shrinks. *'Private equity is driving economic growth and while this benefits a wide range of people, others get left behind. The question is, therefore, what can be done for these people?'* Through the PEF, the private equity industry can focus its resources on tackling this issue, and Shaks doesn't underestimate the potential of the industry in this respect, *'My dream is for private equity to take ownership of this problem. If we could mobilize the entire private equity industry behind this one cause, provide leadership on the social problem of NEETS, there is the potential to have a profound impact.'*

The PEF has developed a rigorous ten-stage process for the selection, screening and development of its investee charities (see below). The selection, due diligence and screening of charities is outsourced to New Philanthropy Capital in order to ensure that the process remains transparent and objective. The 'long list' of charities is then whittled down to a short list of potential candidates, with each one allocated to one of the PEF's eight private equity trustees. The respective trustees then spend some time with their allotted charity, meeting with the board, the chief executive and getting to grips with how it works. The process ends in a set of presentations from each of the short-listed organisations and their assigned trustees.

	<b>Element</b>	<b>Objectives</b>
1	Selection and Due Diligence	Clarity about our objects and the charity's ability to deliver; Search for high performing charities
2	Business & strategic Planning	Ensuring focus and growth of the charity; ensuring the PEF investments yield maximum results
3	SWOT	Engagement and relationship building between charity and PEF Board; ensuring that we understand the challenges and opportunities facing the charity
4	100 Day Plans	Building momentum and engagement from the get go
5	Resource plan and implementation	Capacity building. Sharing our considerable networks with the charity. Facilitating relationships with the corporate world.
6	Impact measurement	Assist PEF to know what works; enable us to know what value our investment is creating
7	Monitoring and Review system	Introduce systems for evidence based management of growth and change; keep PEF donors up to date with their investments
8	Leadership diagnostic and programme	Build the capacity and future proof the charities; ensure we are building a cadre of leaders to solve the NEET problem.
9	NEETs Knowledge Network	Provide portfolio with market research and information; develop a policy programme which helps PEF charities be the best; ensure we are evaluating and supporting the best interventions.
10	Exit and sustainability	Ensure that each charity leaves the portfolio on an upward growth curve

The investment package provided is in the form of a grant structured over three years. As with the private equity process, much of the initial business planning occurs pre-money during the due diligence phase, with a 100-day plan formulated and put in place on completion to ensure early momentum. A SWOT team is appointed to each of the charities, which is led by a trustee as 'deal leader'. The team will initially spend a day with the charity, drawing on other professional services advisors such as Deloitte, Clifford Chance or ICG, to create a 'resource plan' outlining the inputs required to support the organisation's growth strategy, which might include IT support, governance, financial planning or market analysis. After two years, the SWOT team will begin exit planning, preparing the charity for sustainability, ensuring that charities leave the portfolio on an upwards growth trajectory.

## Case Study

### New Philanthropy Capital

New Philanthropy Capital (NPC) is a charity set up in 2001 to advise donors and funders on how to give more effectively. The idea behind NPC came about when a group of ex-Goldman Sachs executives, who had generated considerable personal wealth, decided to focus on increasing their philanthropic activities. In the course of their exploration of the charitable sector, they found that the analysis they were used to accessing during their professional lives was unavailable, making it difficult for them to maximise the quality and effectiveness of their giving. In order to be able to make informed investment decisions, the team set about creating a process to identify the most effective organisations tackling particular social issues. The process focused on producing independent research and analysis exploring the different approaches to a particular social issue, measuring the effectiveness of different organisations, gauging levels of government support, and identifying the areas that would benefit most from private sector funding. The process was initially set up to serve the needs of the founders, though this was soon extended to other philanthropic donors. *'Our clients are seeking a rational, logical and evidence-based approach to implementing their more emotional-led commitment to a particular cause or social issue. They want information to support their decision-making,'* says Tris Lumley, senior research analyst at NPC.

NPC's donor advisory service covers individuals, trusts and foundations and corporates, providing a level of service tailored to each client's needs: *'in the past three years, we've provided individual clients, family foundations and charitable trusts with advisory services on areas of particular interest to them, building up portfolios of charities for them. Sometimes we'll be given a cheque for, say £250,000 and asked to distribute it to six or seven charities, providing an update in a year's time. For other clients who want a more hands-on involvement, we'll make initial recommendations based on the fit between the client's objectives and due diligence of the charities,'* says Tris Lumley. NPC also worked with the Private Equity Foundation, the industry-level initiative launched 2006, helping it to establish its investment selection and due diligence processes, as well as advising on the measurement of social impact across its portfolio.

In the first year, New Philanthropy Capital operated in a very 'donor-led' way, providing bespoke research and services for individual clients. However, in order to maximise its own impact, the organisation began to make its research more widely available, publishing in-depth reports on areas of charitable activity such as domestic violence and after school clubs. NPC has now produced 24 such reports, which are freely available on its website, providing a first port of call for interested donors.

This commitment to fostering a culture of information exchange in the charitable and not for profit sector is further reflected in one of NPC's new ventures, the creation of an online 'Results Library' to provide a central forum for individual charities to post information on their social impact. The site will collect together the results and costs of charities' work as well as costs of different social problems to the individual concerned, to the Government and to wider society, allowing fragmented data sources to be collated and evaluated (*see page 43*). *'I think the sector needs infrastructure in order to grow. It is hard for funders coming into the sector to ensure that they are finding and investing in the right organisation, and hard for charities to share information about their approaches and results. With the Results Library, we're trying to take NPC's direct model and create funding relationships that reach beyond our organisation. Our reach is only as broad as our resources allow, and we're looking to create something much larger — the infrastructure for more effective information exchange.'* Tris Lumley.

## **APPENDICES**

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**United Nations - The Principles for Responsible Investment**

Source: [www.unpri.org](http://www.unpri.org)

As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and corporate governance (ESG) issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time). We also recognise that applying these Principles may better align investors with broader objectives of society. Therefore, where consistent with our fiduciary responsibilities, we commit to the following:

***1 We will incorporate ESG issues into investment analysis and decision-making processes.***

Possible actions:

- Address ESG issues in investment policy statements
- Support development of ESG-related tools, metrics, and analyses
- Assess the capabilities of internal investment managers to incorporate ESG issues
- Assess the capabilities of external investment managers to incorporate ESG issues
- Ask investment service providers (such as financial analysts, consultants, brokers, research firms, or rating companies) to integrate ESG factors into evolving research and analysis
- Encourage academic and other research on this theme
- Advocate ESG training for investment professionals

***2 We will be active owners and incorporate ESG issues into our ownership policies and practices.***

Possible actions:

- Develop and disclose an active ownership policy consistent with the Principles
- Exercise voting rights or monitor compliance with voting policy (if outsourced)
- Develop an engagement capability (either directly or through outsourcing)
- Participate in the development of policy, regulation, and standard setting (such as promoting and protecting shareholder rights)
- File shareholder resolutions consistent with long-term ESG considerations
- Engage with companies on ESG issues
- Participate in collaborative engagement initiatives
- Ask investment managers to undertake and report on ESG-related engagement

***3 We will seek appropriate disclosure on ESG issues by the entities in which we invest.***

Possible actions:

- Ask for standardised reporting on ESG issues (using tools such as the Global Reporting Initiative)
- Ask for ESG issues to be integrated within annual financial reports
- Ask for information from companies regarding adoption of/adherence to relevant norms, standards, codes of conduct or international initiatives (such as the UN Global Compact)
- Support shareholder initiatives and resolutions promoting ESG disclosure

**4 We will promote acceptance and implementation of the Principles within the investment industry.**

Possible actions:

- Include Principles-related requirements in requests for proposals (RFPs)
- Align investment mandates, monitoring procedures, performance indicators and incentive structures accordingly (for example, ensure investment management processes reflect long-term time horizons when appropriate)
- Communicate ESG expectations to investment service providers
- Revisit relationships with service providers that fail to meet ESG expectations
- Support the development of tools for benchmarking ESG integration
- Support regulatory or policy developments that enable implementation of the Principles

**5 We will work together to enhance our effectiveness in implementing the Principles.**

Possible actions:

- Support/participate in networks and information platforms to share tools, pool resources, and make use of investor reporting as a source of learning
- Collectively address relevant emerging issues
- Develop or support appropriate collaborative initiatives

**6 We will each report on our activities and progress towards implementing the Principles.**

Possible actions:

- Disclose how ESG issues are integrated within investment practices
- Disclose active ownership activities (voting, engagement, and/or policy dialogue)
- Disclose what is required from service providers in relation to the Principles
- Communicate with beneficiaries about ESG issues and the Principles
- Report on progress and/or achievements relating to the Principles using a 'Comply or Explain'<sup>1</sup> approach
- Seek to determine the impact of the Principles
- Make use of reporting to raise awareness among a broader group of stakeholders

<sup>1</sup>The Comply or Explain approach requires signatories to report on how they implement the Principles, or provide an explanation where they do not comply with them.

The Principles for Responsible Investment were developed by an international group of institutional investors reflecting the increasing relevance of environmental, social and corporate governance issues to investment practices. The process was convened by the United Nations Secretary-General.

In signing the Principles, we as investors publicly commit to adopt and implement them, where consistent with our fiduciary responsibilities. We also commit to evaluate the effectiveness and improve the content of the Principles over time. We believe this will improve our ability to meet commitments to beneficiaries as well as better align our investment activities with the broader interests of society.

We encourage other investors to adopt the Principles.

Appendix 2  
**Equator Principles**  
Statement of Principles

The following outlines the key elements of the Equator Principles, that have been adopted by organisations within the banking community. For more information on the scheme, see [www.equator-principles.com](http://www.equator-principles.com).

EPFIs will only provide loans to projects that conform to Principles 1-9 below:

**Principle 1: Review and Categorisation**

When a project is proposed for financing, the EPFI will, as part of its internal social and environmental review and due diligence, categorise such project based on the magnitude of its potential impacts and risks in accordance with the environmental and social screening criteria of the International Finance Corporation (IFC) (Exhibit I).

**Principle 2: Social and Environmental Assessment**

For each project assessed as being either Category A or Category B, the borrower has conducted a Social and Environmental Assessment (“Assessment”) process<sup>30</sup> to address, as appropriate and to the EPFI’s satisfaction, the relevant social and environmental impacts and risks of the proposed project (which may include, if relevant, the illustrative list of issues as found in Exhibit II). The Assessment should also propose mitigation and management measures relevant and appropriate to the nature and scale of the proposed project.

**Principle 3: Applicable Social and Environmental Standards**

For projects located in non-OECD countries, and those located in OECD countries not designated as High-Income, as defined by the World Bank Development Indicators Database, the Assessment will refer to the then applicable IFC Performance Standards (Exhibit III) and the then applicable Industry Specific EHS Guidelines (“EHS Guidelines”) (Exhibit IV). The Assessment will establish to a participating EPFI’s satisfaction the project’s overall compliance with, or justified deviation from, the respective Performance Standards and EHS Guidelines.

The regulatory, permitting and public comment process requirements in High-Income OECD Countries, as defined by the World Bank Development Indicators Database, generally meet or exceed the requirements of the IFC Performance Standards (Exhibit III) and EHS Guidelines (Exhibit IV). Consequently, to avoid duplication and streamline EPFI’s review of these projects, successful completion of an Assessment (or its equivalent) process under and in compliance with local or national law in High-Income OECD Countries is considered to be an acceptable substitute for the IFC Performance Standards, EHS Guidelines and further requirements as detailed in Principles 4, 5 and 6 below. For these projects, however, the EPFI still categorises and reviews the project in accordance with Principles 1 and 2 above.

The Assessment process in both cases should address compliance with relevant host country laws, regulations and permits that pertain to social and environmental matters.

**Principle 4: Action Plan and Management System**

For all Category A and Category B projects located in non-OECD countries, and those located in OECD countries not designated as High-Income, as defined by the World Bank Development Indicators Database, the borrower has prepared an Action Plan (AP)<sup>31</sup> which

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<sup>30</sup> **Social and Environmental Assessment** is a process that determines the social and environmental impacts and risks (including labour, health, and safety) of a proposed project in its area of influence. For the purposes of Equator Principles compliance, this will be an adequate, accurate and objective evaluation and presentation of the issues, whether prepared by the borrower, consultants or external experts. Depending on the nature and scale of the project, the assessment document may comprise a full-scale social and environmental impact assessment, a limited or focused environmental or social assessment (e.g. audit), or straight-forward application of environmental siting, pollution standards, design criteria, or construction standards. One or more specialised studies may also need to be undertaken.

<sup>31</sup> The **Action Plan** may range from a brief description of routine mitigation measures to a series of documents (e.g., resettlement action plan, indigenous peoples plan, emergency preparedness and response plan, decommissioning



addresses the relevant findings, and draws on the conclusions of the Assessment. The AP will describe and prioritise the actions needed to implement mitigation measures, corrective actions and monitoring measures necessary to manage the impacts and risks identified in the Assessment. Borrowers will build on, maintain or establish a Social and Environmental Management System that addresses the management of these impacts, risks, and corrective actions required to comply with applicable host country social and environmental laws and regulations, and requirements of the applicable Performance Standards and EHS Guidelines, as defined in the AP.

For projects located in High-Income OECD countries, EPFIs may require development of an Action Plan based on relevant permitting and regulatory requirements, and as defined by host-country law.

#### **Principle 5: Consultation and Disclosure**

For all Category A and, as appropriate, Category B projects located in non-OECD countries, and those located in OECD countries not designated as High-Income, as defined by the World Bank Development Indicators Database, the government, borrower or third party expert has consulted with project affected communities in a structured and culturally appropriate manner<sup>32</sup>. For projects with significant adverse impacts on affected communities, the process will ensure their free, prior and informed consultation and facilitate their informed participation as a means to establish, to the satisfaction of the EPFI, whether a project has adequately incorporated affected communities' concerns.<sup>33</sup>

In order to accomplish this, the Assessment documentation and AP, or non-technical summaries thereof, will be made available to the public by the borrower for a reasonable minimum period in the relevant local language and in a culturally appropriate manner. The borrower will take account of and document the process and results of the consultation, including any actions agreed resulting from the consultation. For projects with adverse social or environmental impacts, disclosure should occur early in the Assessment process and in any event before the project construction commences, and on an ongoing basis.

#### **Principle 6: Grievance Mechanism**

For all Category A and, as appropriate, Category B projects located in non-OECD countries, and those located in OECD countries not designated as High-Income, as defined by the World Bank Development Indicators Database, to ensure that consultation, disclosure and community engagement continues throughout construction and operation of the project, the borrower will, scaled to the risks and adverse impacts of the project, establish a grievance mechanism as part of the management system. This will allow the borrower to receive and facilitate resolution of concerns and grievances about the project's social and environmental performance raised by individuals or groups from among project-affected communities. The borrower will inform the affected communities about the mechanism in the course of its community engagement process and ensure that the mechanism addresses concerns promptly and transparently, in a culturally appropriate manner, and is readily accessible to all segments of the affected communities.

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plan, etc). The level of detail and complexity of the Action Plan and the priority of the identified measures and actions will be commensurate with the project's potential impacts and risks. Consistent with Performance Standard 1, the internal **Social and Environmental Management System** will incorporate the following elements: (i) Social and Environmental Assessment; (ii) management program; (iii) organisational capacity; (iv) training; (v) community engagement; (vi) monitoring; and (vii) reporting.

<sup>32</sup> **Affected communities** are communities of the local population within the project's area of influence who are likely to be adversely affected by the project. Where such consultation needs to be undertaken in a structured manner, EPFIs may require the preparation of a Public Consultation and Disclosure Plan (PCDP).

<sup>33</sup> **Consultation** should be "free" (free of external manipulation, interference or coercion, and intimidation), "prior" (timely disclosure of information) and "informed" (relevant, understandable and accessible information), and apply to the entire project process and not to the early stages of the project alone. The borrower will tailor its consultation process to the language preferences of the affected communities, their decision-making processes, and the needs of disadvantaged or vulnerable groups. Consultation with Indigenous Peoples must conform to specific and detailed requirements as found in Performance Standard 7. Furthermore, the special rights of Indigenous Peoples as recognised by host-country legislation will need to be addressed.

**Principle 7: Independent Review**

For all Category A projects and, as appropriate, for Category B projects, an independent social or environmental expert not directly associated with the borrower will review the Assessment, AP and consultation process documentation in order to assist EPFI's due diligence, and assess Equator Principles compliance.

**Principle 8: Covenants**

An important strength of the Principles is the incorporation of covenants linked to compliance. For Category A and B projects, the borrower will covenant in financing documentation:

- a) to comply with all relevant host country social and environmental laws, regulations and permits in all material respects;
- b) to comply with the AP (where applicable) during the construction and operation of the project in all material respects;
- c) to provide periodic reports in a format agreed with EPFIs (with the frequency of these reports proportionate to the severity of impacts, or as required by law, but not less than annually), prepared by in-house staff or third party experts, that i) document compliance with the AP (where applicable), and ii) provide representation of compliance with relevant local, state and host country social and environmental laws, regulations and permits; and
- d) to decommission the facilities, where applicable and appropriate, in accordance with an agreed decommissioning plan.

Where a borrower is not in compliance with its social and environmental covenants, EPFIs will work with the borrower to bring it back into compliance to the extent feasible, and if the borrower fails to re-establish compliance within an agreed grace period, EPFIs reserve the right to exercise remedies, as they consider appropriate.

**Principle 9: Independent Monitoring and Reporting**

To ensure ongoing monitoring and reporting over the life of the loan, EPFIs will, for all Category A projects, and as appropriate, for Category B projects, require appointment of an independent environmental and/or social expert, or require that the borrower retain qualified and experienced external experts to verify its monitoring information which would be shared with EPFIs.

**Principle 10: EPFI Reporting**

Each EPFI adopting the Equator Principles commits to report publicly at least annually about its Equator Principles implementation processes and experience, taking into account appropriate confidentiality considerations.<sup>34</sup>

*Source: [www.equator-principles.com](http://www.equator-principles.com)*

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<sup>34</sup> Such reporting should at a minimum include the number of transactions screened by each EPFI, including the categorisation accorded to transactions (and may include a breakdown by sector or region), and information regarding implementation.

## Appendix 3 Education

For those investment professionals looking to engage with social ventures there are a variety of opportunities that range from non-profit through to fully commercial. Launchpad provides an example of the range of organisational models that are being developed to achieve social aims in the education sector which historically has been typified by purely public sector or charitable approaches. As highlighted below the range includes a model for a new type of school, not for profit, social enterprise and fully commercial models.

### **A Public Body: Studio Schools**

Studio Schools have been designed to help 14-19 year olds better prepare for the world of work. They draw on extensive experience from the UK and around the world and bring together a number of proven elements in a new kind of school that will provide young people with qualifications and a full range of skills – while also engaging them in working in, and running, businesses and social enterprises directly serving customers.

Studio Schools will be small schools of around 300 students. They will teach the national curriculum through interdisciplinary, enterprise-themed projects, but will have a very different style and ethos to most existing schools, with a much stronger emphasis on practical work and enterprise. Every student will have a personal coach; there will be mixed age teams; and the schools will have many of the features of a workplace (like booking holidays). Studio Schools do not aim to replace other secondary schools – but to complement them by providing an alternative approach suitable for young people looking for a more entrepreneurial option or alienated by traditional pedagogy.

Elements of the Studio School model are the subject of a field trial with Barnfield College and Barnfield Academy West in Luton in collaboration with The Innovation Unit. The field trial began in September 2007 with 23 14-year olds and will eventually be scaled up to a full Studio School. The Young Foundation currently has plans to develop eight new schools with partners from Tyneside in the North to the East End of London, Newham Council and College, and the Councils in Barnsley, Blackpool, Kirklees, Oldham, Sheffield, and South Tyneside.

### **Not for Profit Models: Teach Too and Faking It**

The goal of Teach Too is to bring business expertise into the education sector by offering a respected mechanism that allows business people to spend some of their working week in a school adding value and gaining new skills. This project was initiated by Launchpad and is currently in the research and development stage. It is anticipated that this will take a not for profit format.

Faking It, based on the television programme of the same name, is an intense transformational experience in which young people 'fake it' in an unfamiliar job and world. They will quickly learn skills and adopt appropriate personas, opening their eyes to different career opportunities and giving them a real-world learning experience. Whilst Launchpad is experimenting with alternative revenue structures that will come from spin-off products around the concept, it is anticipated that the final structure will be not for profit. This project was initiated by Launchpad and is currently in the research and development stage.

### **Commercial Models: School of Everything and Arrival Education**

School of Everything ([www.schoolofeverything.com](http://www.schoolofeverything.com)) is an online market place for learning. It aims to create a new bottom-up education system, making it simple for anyone to find a teacher, advertise their teaching services and arrange a teaching session. Launchpad has provided start-up funding, supported the commercial and operational development of the concept and mentored the dynamic team of entrepreneurs developing the concept. School of Everything recently completed a successful first stage funding round, from a group of angels and other early stage investors.

Arrival Education provides students, chosen for their leadership and ability to influence others, with the opportunity to work at their dream job, through Arrival's expanding network of '1000 most aspirational companies'. These placements take place following a concentrated practical 'Success-skills' course facilitated by Arrival staff in high-profile corporate environments. The programme emphasises the softer and practical skills vital to succeed in work and life whilst being in a personalised context for all participants. Basing the students in such surroundings further raises the importance of the programme and its practical focus – both in their eyes and those of their peers, generating further ripples of impact through a 'peer-leverage' approach. The concept is being developed with a commercial focus as a sustainable social enterprise.

## Appendix 4 Establishing a Philanthropy Programme

### Case Study

#### **Coutts Private Bank - Philanthropy Advisory**

Alongside Coutts traditional private banking activities, the organisation provides a philanthropy advisory service. Within the private equity industry, clients have included both individual executives and firms. This offering includes four key elements:

1. *Philanthropy:*  
Guidance in the development of a strategic approach to maximise the impact of giving. Access to education and networking with other donors through the Coutts Forums for Philanthropy and the Coutts Handbook for Philanthropy is also available.
2. *Trusts:*  
A service is available to establish trusts and manage on-going administration and reporting.
3. *Charitable investments:*  
Bespoke investment strategies can be developed to enable private family charitable trusts to maximise the assets upon which their good work depends.
4. *Commercial banking:*  
The bank is also able to take care of the day-to-day banking needs of private family trusts.

#### **Examples**

A senior partner of a leading private equity firm approached Coutts for advice as he and his wife wished to involve their teenage children in charitable giving. The idea evolved as his wife had attended a Coutts Forum for Philanthropy in London and was inspired to get more involved in giving as a family. Coutts Philanthropy team had an initial meeting with the family to understand their objectives and present the possible options for choosing an appropriate vehicle for their philanthropy. They chose to set up a charitable trust and endow it with a 7-figure sum, with the idea of giving away the income each year. Coutts took care of all the paperwork and the family trust was ready in 8 weeks. Coutts' philanthropy team arranged a series of half-day workshops for the family to learn more about the subject they were most interested in - homelessness. This involved briefings from organisations like New Philanthropy Capital, the Institute for Philanthropy and the Community Foundation Network and entailed a discussion of the causes of homelessness. Coutts charity investment team invested the endowed funds on behalf of the Trust.

Separately, Coutts was approached by a mid-sized venture capital firm that was keen to set up a charitable trust to channel the company's giving. Coutts set up the Trust and the company opted to endow it with a 6-figure sum which would be topped up each year with the partners' contributing a percentage of the company's profits. The partners were keen to fund work relating to the education of disadvantaged young people in the UK and did not have the time to find good charities. Coutts Philanthropy team thus introduced the partners to a specialist advisor, New Philanthropy Capital, who suggested a shortlist of charities based on their research into charitable work in the area of education.

## Case Study Pilot Light

PilotLight offers an interesting take on the venture philanthropy model, providing a conduit between charities with growth ambition and the skills and resource of experienced city professionals. Founder Fiona Halton first began to explore the venture philanthropy model back in 2001, having become interested in the approaches being adopted by US groups such as New Profit Inc and Venture Philanthropy Partners, which offer a hybrid of skills and capital to the charities they support. Having begun a dialogue with a number of professionals keen to develop a more engaged approach to philanthropy, Fiona concluded that the most valuable asset they had to give was their time and skills: *'City workers have skill sets that would be highly valuable in terms of coaching and developing charities into sustainable organisations. Many smaller charities lack the profile to attract high-calibre trustees, so their skill base can be quite thin.'* Fiona also perceived a desire amongst individual philanthropists to gain access and guidance in relation to the charitable sector, so they could become more engaged and effective in their own philanthropic activities. PilotLight acts as facilitators in bridging the gap between the business and charitable sector, providing a two-way learning experience for charity trustees and directors and city professionals, *'PilotLighters tend to evolve their philanthropic strategies once they've had some hands on experience of the sector. Sometimes they go on to become trustees, and in general, they tend to understand an issue-area much better.'*

However, facilitating an ongoing resource commitment from a busy city professional is perhaps more easily said than done: *'Professionals can be wary of giving time, because of the problems associated with organisations becoming dependent on them, particularly when it comes to withdrawing support at the end of the association,'* says Fiona. In order to create an effective partnership between a charity and its allocated team of volunteers, a full-time member of the PilotLight team is allocated to each project, to act as facilitator and a 'cultural translator': *'Our in-house project managers provide a key liaison role between the charity and the PilotLighters. There is no direct contact between the two parties; the project manager acts as a broker for the relationship and provides a protective layer for each party,'* says Fiona. The project managers also provide a cultural bufferzone: *'City workers tend to expect results very quickly. We have to explain to them that the voluntary sector moves much more slowly.'* This intermediation process ensures that both parties derive the maximum benefit and minimal disruption from the association. Each volunteering executive commits two to three hours a month to their allocated charity, with meetings arranged to fit around busy schedules.

In order to select the most suitable charities, a rigorous evaluation process is carried out by PilotLight. Charities with growth ambition, a turnover greater than £3m, a full-time staff member, and an open, communicative and receptive attitude to the process of evaluation are short-listed. After the evaluation process, the PilotLight team works out what is most needed to take the selected charity to the next phase of its development, whether that's team leadership, strategic thinking, IT resource, marketing expertise, or public sector expertise. A four-strong team of PilotLighters is then put together, drawing on individuals with skills that best meet the charities requirements.

In terms of business planning, a holistic view is taken of a charity's needs, *'when charities ask for help, their problems tend to be linked to fundraising or marketing. However, we try to diagnose the underlying problems,'* says Fiona. Each charity's progress is then closely monitored on three key metrics: i) change in the charity's capacity to run itself, in terms of strategic planning, governance and financial management; ii) turnover growth; and iii) social impact on the community. Each assignment tends to take around 18-months, and the process remains highly exit focused, 'while some charities will never be fully sustainable, we are always working towards sustainability. Our process is very exit-focused and at the end of the 18-months, several further projects may emerge and the PilotLighters will then decide whether there is a role for them going forward, or whether it's time to exit.'

The benefits to participants in the PilotLight scheme are substantial, according to Fiona, both for the PilotLighters and the charities: *'There is a lot of prejudice in the charitable sector when it comes to business people. The PilotLight process enables a dialogue to grow, with both sides contributing complementary skill sets. We create a safe environment for this partnership to evolve and for two-way respect to build. Generally, both parties find the experience very rewarding.'*

Case Study  
**Philanthropy UK**

Philanthropy UK is an online information service, catering for individuals and organisations that are at the earliest stages for their philanthropic journey: *'We are a first port of call for anyone interested in Philanthropy. We provide information on the different mechanisms for giving, tax implications, case studies, as well as putting people in touch with useful organisations that can provide practical support, such as New Philanthropy Capital,'* says Susan Mackenzie.

Philanthropy UK also produces a 'Guide to Giving', with the second edition due out in April 2008. The Guide is free and provides clear, practical and objective guidance on a variety of approaches to and mechanisms for giving. The Guide also serves to sign post the growing community of intermediary organisations that are springing up to help donors give more effectively, providing another conduit between philanthropists and the third sector organisations seeking capital and resource.

Case Study  
**Institute for Philanthropy**

The Institute for Philanthropy was founded in 2000 and its mission is to increase effective philanthropy in the UK and overseas. The organisation provides training to schools, community foundations and individual philanthropists in strategic philanthropy, equipping current and would-be philanthropists with the necessary tools to optimise their impact

The Institute's strategic approach to philanthropy incorporates the following key strands:

- a) Mapping the sector or field (e.g. offender rehabilitation, domestic violence)
- b) Identifying the organisations operating in that field
- c) Creating a 'theory of change' to optimise effective impact within the sector
- d) Identifying the interventions or steps necessary to implement the theory of change
- e) Investment of capital and/or skills
- f) Evaluation

Fenella Rouse, director of operations at the Institute, explains their approach: *'We help people to explore the kind of interventions that would be required to make a real impact on a social issue through researching the underlying problem. We help people to build their own philanthropic programmes through teaching them how to undertake due diligence or assess impact in an area, for instance.'*

## Appendix 5

### **Companies Act – Responsibilities to stakeholders**

The Companies Act introduces on to the statute book for the first time the concept of the 'stakeholder' as someone other than a shareholder who has an indirect interest in what a company may be doing. The act states:

A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to:

- (a) the likely consequences of any decision in the long term
- (b) the interests of the company's employees
- (c) the need to foster the company's business relationships with suppliers, customers and others
- (d) the impact of the company's operations on the community and the environment
- (f) the desirability of the company maintaining a reputation for high standards of business conduct, and
- (g) the need to act fairly as between members of the company



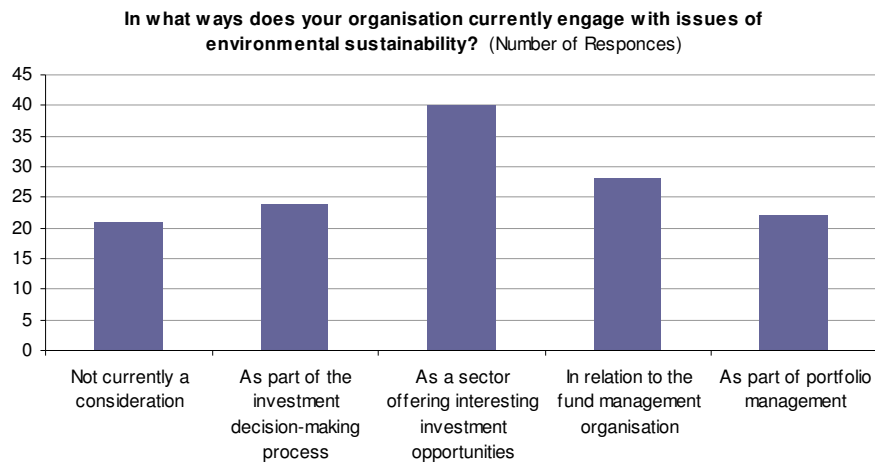
Appendix 6  
**Online Survey Results**

During December 2007, an online 'straw poll' survey was carried out as part of the research for this project, to provide an insight into the broad consensus of opinion regarding issues relating to CSR, social investment and philanthropy within the venture capital and private equity community. The survey targeted BVCA members, and consisted of seven multiple choice questions (*see Appendix 7, methodology notes for more details*). The following section provides a summary of the results from the survey, some of which have been quoted elsewhere in this report.

Q1

**In what ways does your organisation currently engage with issues of environmental sustainability?**

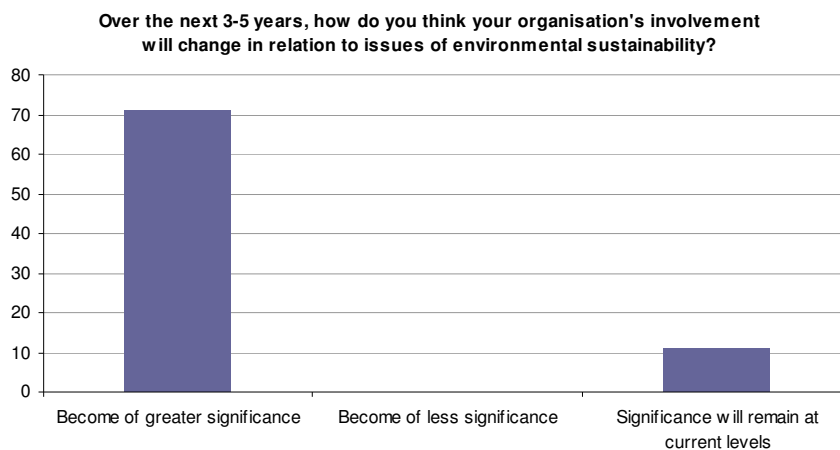
*Please note, respondents could provide one or more responses to this question.*



Q2

**Over the next 3-5 years, how do you think your organisation's involvement will change in relation to issues of environmental sustainability?**

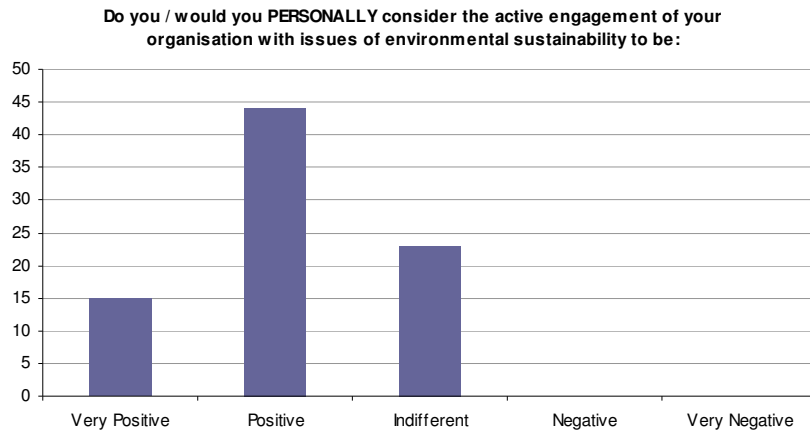
*Please note, respondents could select just one response to this question.*



Q3

**Do you / would you PERSONALLY consider the active engagement of your organisation with issues of environmental sustainability to be:**

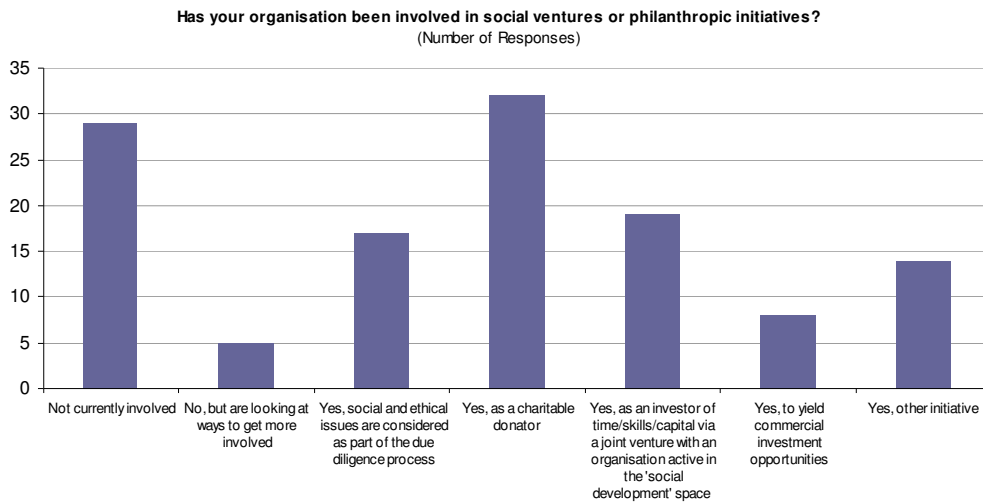
*Please note, respondents could select just one response to this question.*



Q4

**Has your organisation been involved in social ventures or philanthropic initiatives?**

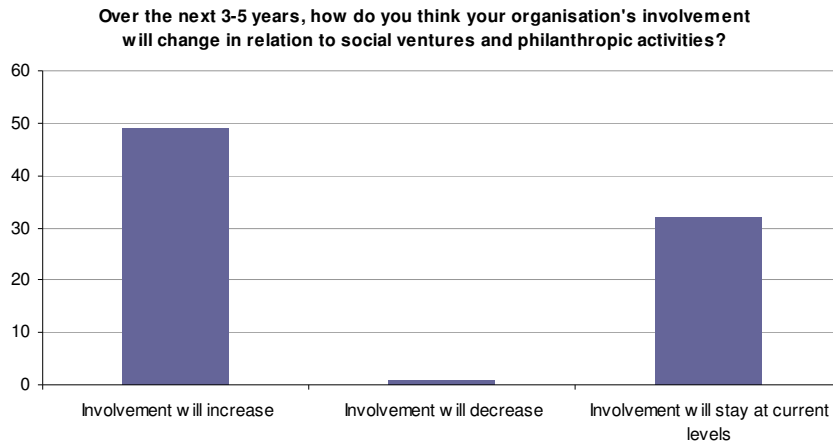
*Please note, respondents could select one or more responses to this question.*



Q5

**Over the next 3-5 years, how do you think your organisation's involvement will change in relation to social ventures and philanthropic activities?**

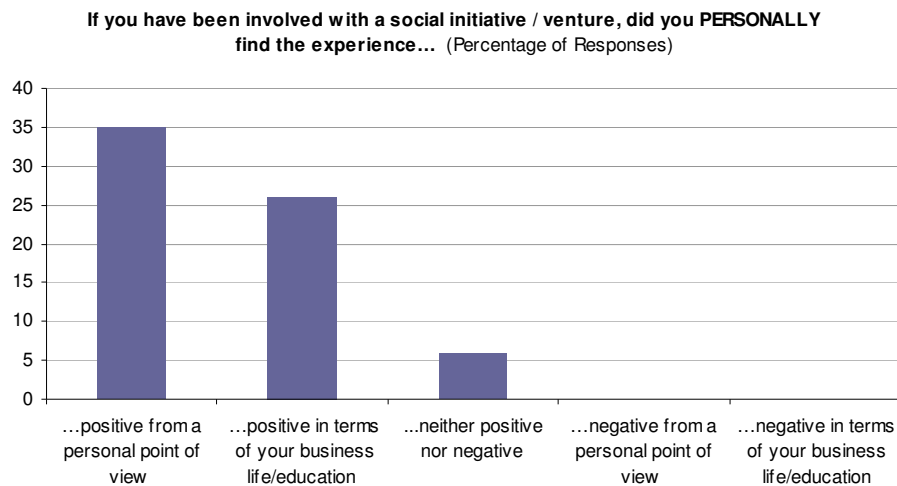
*Please note, respondents could select just one response to this question.*



Q6a

**a) If you have been involved with a social initiative / venture, did you PERSONALLY find the experience...**

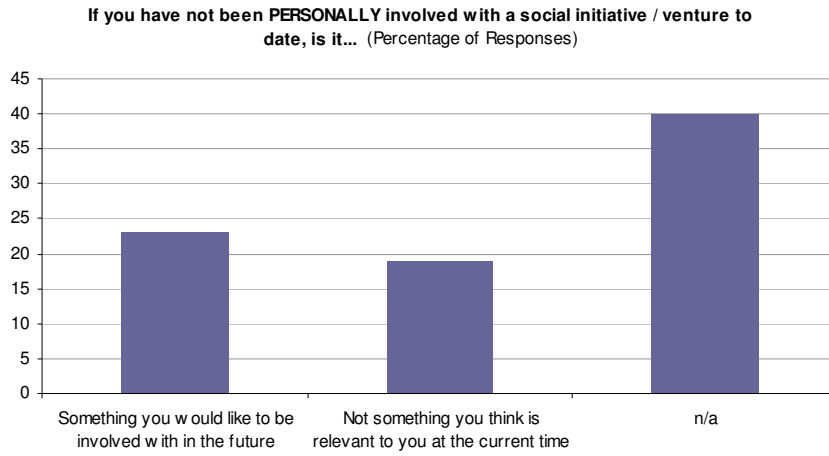
*Please note, respondents could select one or more responses to this question. Please also note that this question was relevant only to the proportion of the sample that had been involved with a social venture. This was the case for 52% of the total respondent population.*



Q6b

**b) If you have not been PERSONALLY involved with a social initiative / venture to date, is it...**

*Please note, respondents could select just one response to this question.*



## Appendix 7 **Methodology**

The research for this report was carried out by Arbor Square Associates in conjunction with The Young Foundation between November 2007 and February 2008.

The research phase included three elements: desk research, an online poll of BVCA members, and in-depth interviews with representatives of organisations operating in the venture capital and private equity industries, as well as organisations supporting the third sector.

### ***Online Survey***

A survey of full BVCA members was carried out to canvas overall opinions on the likely future significance of issues relating to CSR, social investment and philanthropy over the coming years. The survey was conducted via an online questionnaire form with a series of closed end questions requiring either one or multiple answers to be selected from multiple choice options.

Invitations to participate in the on-line poll were sent (from the BVCA itself) to representatives of all 210 of the BVCA's full members. A total of 85 responses were received from executives in 71 firms, 34% of the BVCA membership. The survey was conducted on a confidential non-disclosed basis.

### ***Interviews***

The main body of research undertaken for this report took the form of in-depth qualitative interviews with representatives of the mainstream private equity and third sector spaces.

A total of 61 interviews were carried out with individuals from 57 organisations across the spectrum outlined in this report. This included 12 mainstream venture capital or private equity firms, eight specialist private equity firms, 19 representatives from organisations principally in the social investment space, and 15 organisations primarily involved in the philanthropy part of the spectrum.

Interviews were conducted either in person or over the phone with senior representatives of the respondent organisations; the interviews lasted on average around 45 minutes. Interviews took the form of peer-to-peer conversations framed around key themes relevant to the part of the sector in which the respondent organisation was active. The information produced as a result of this process was qualitative in nature. A list of participating organisations can be found at the end of the main body of the report.

### ***About Arbor Square***

Founded in 2006, Arbor Square is a research-based consultancy firm, providing services to groups operating within the alternative assets industry. The consultants are information specialists, with an unrivalled knowledge of data and relevant contextual research. They have more than 40 years cumulative experience of private equity and have worked together as a team in various guises for over eight years.

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### ***About The Young Foundation***

The Young Foundation is a centre for social innovation combining practical projects, the creation of new ventures, social research and publishing. Our goal is to speed up society's ability to respond to changing social needs through innovating and replicating new methods and models. Under Michael Young, one of the most influential social thinkers and entrepreneurs of the 20th century, the Foundation and its predecessors were involved in creating more than 60 new ventures, including the Open University, Consumers Association and precursors to NHS Direct and the Expert Patients Programme. Today through its early stage social venturing unit, Launchpad, we develop promising ideas into new ventures by providing funding, social capital and entrepreneurial expertise.

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