FROM GROWING INTEREST TO INTEREST GROWN

Is the youth sector ready for social investment?

Gemma Rocyn Jones, March 2013

THE YOUNG FOUNDATION
THINKING
ACTION
CHANGE

About The Young Foundation

We are The Young Foundation and we are determined to make positive social change happen. We pioneered the field of social innovation with The Open University, UpRising and Studio Schools. We work closely with individuals, communities and partners, building relationships to ensure that our thinking does something, our actions matter and the changes we make together will continue to grow.

www.youngfoundation.org

About Catalyst

Catalyst is a consortium of four organisations working with the Department for Education (DfE) as the strategic partner for young people, as part of the Department's wider transition programme for the sector. Catalyst is working to deliver three key objectives over a two-year period. We are strengthening the youth sector market, equipping the sector to work in partnership with Government and co-ordinating a skills development strategy for the youth sector's workforce.

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INTRODUCTION

Local authority expenditure on services for young people fell by £307.5 million between 2010–1 and 2011–12. During this period, social sector organisations saw their funding reduced by 14 per cent.[1] Over the same time, the social finance market has grown rapidly to over £600 million offering funding to generate both a social and financial return. The potential of this emerging breed of social investors to support youth sector organisations to innovate and scale, was the subject of a 2011 report by The Young Foundation, *Growing Interest.*[2]

We found evidence to suggest that social finance could offer both financial breathing space and the freedom to innovate to a sector that had suffered significant funding cuts. Moreover, this opinion was shared by one in five youth sector organisations surveyed for the report, who expected social investment to have become an integral source of funding by 2014.

However, this number fell to just one in 10 when asked whether they were immediately 'ready' for investment. Our interviews with youth sector leaders, and The Young Foundation's wider experience of the social investment market, enabled us to identify three key areas that organisations needed to strengthen to access social investment: their *capability* to understand the requirements of social finance and how to articulate their impact; their *capacity* to develop new skills and adopt new business practices; and their *confidence* in their future sources and volume of income – in other words, the financial sustainability of their operating model.

These findings formed the basis of an investment readiness programme targeting voluntary youth sector organisations, which The Young Foundation ran between October 2011 and March 2013 on behalf of Catalyst.

The programme was designed to build the sector's awareness of social investment and address the three challenges identified by our earlier work. We did this through a series of seminars, masterclasses and one-to-one advice. This report outlines the lessons from 18 months of working with over 350 youth sector organisations. Was our assessment of investment readiness needs correct? Is social investment living up to its potential in the youth sector? And if not, what lessons have we learned?

Our observations are based on qualitative feedback from group sessions and one-to-one discussions and quantitative data from a survey on sources and need for financing. The report aims to further understand what the appropriate role for social investment might be within the youth sector as well as recognise the support needed to realise this potential.

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[1] http://www.education.gov.uk/rsgateway/DB/SFR/s001114/index.shtml

[2] *Growing Interest: Mapping the market for social finance in the youth sector*, The Young Foundation, July 2011

EXECUTIVE SUMMARY

It is tough being a young person in the UK today. Unemployment, failures in the education system and high levels of young people not in education, employment or training are being compounded by cuts to youth services and funding for voluntary youth sector organisations. The youth sector plays an important role in supporting young people to develop the social and emotional capabilities they need to make a successful transition to adulthood. However, it is under severe pressure from changes to commissioning practices and budget constraints.

Social investment cannot compensate for reduced funding to deliver services, but there are two useful roles it can play. Firstly, it can supply working capital for providers working to payment by results contracts. Social investors are already leading the way in this, supporting youth organisations through the DWP Innovation Fund or the Essex Council social impact bond. Secondly, it can provide the capital investment for youth organisations with a sustainable revenue-based business model to scale up their model or invest in new areas.

Between October 2011 and March 2013, The Young Foundation ran an investment readiness programme, targeting youth sector organisations. The programme had two core aims: firstly, to raise awareness of social investment across the youth sector and secondly to support individual organisations on their journey to securing investment. Over the course of 18 months, The Young Foundation delivered introductory seminars on social investment to over 350 youth sector organisations and provided investment readiness support through masterclasses and one-to-one advice to a further 20.

INVESTMENT READINESS IN FOUR STAGES

We found that the perception and the reality of the sector's investment readiness were quite different. The characteristics of an outwardly successful organisation (even with a dynamic CEO), with a track record of positive outcomes and a strong regional or national presence, are not a guarantee of a sustainable revenue-based business model or a robust strategic plan, which social investment requires.

This experience has led us to break down the process of becoming investment ready into four key stages. The key lessons from our programme of investment readiness support are set out below.

1. Awareness and understanding. Organisations need to understand the fundamental opportunities and threats of taking on debt finance, overcoming common misconceptions. Risk appetite and unease over a not-for-profit organisation taking on debt need to be addressed.

2. Identifying specific funding. Youth sector organisations often self-identify as being ready with their investment proposition. However, many of them are unable to answer basic questions such as how much funding is needed, what it will be spent on, when it is needed, and how and when it will be repaid. Invariably, organisations need to go back to basics and focus on developing a clear and detailed strategic plan. The appropriate form of financing comes out of this work.

3. Developing an investible proposition. Organisations must develop a detailed and well evidenced business plan and financial model. A lack of financial and human resources are the

main barrier. This issue is made worse by the rapidly changing environment in which youth sector organisations operate.

4. Accessing investors. Identifying who investors are and when to approach them is confusing and should not be overlooked as a barrier.

KEY CHALLENGES

Unlocking latent demand. We need to tackle the root causes of why organisations mistrust the social investment market. There is a perception that investment is inappropriate or too risky. This leads to social investment being dismissed outright or organisations struggling to see past the associated risk to balance this against the potential upside of achieving sustainability. Tackling this requires a change in attitude and behaviour. This change needs to happen at all levels, from youth worker to management teams to trustees. It also requires social investors to make special efforts to demonstrate social mission and values to potential investees in this sector.

Rapid pace of change in the external environment. Funding and commissioning practices are changing extremely rapidly at the same time as the overall level of funding for the youth sector is reducing dramatically. Consequently, youth sector organisations are generally struggling to adapt fast enough. To become investment ready most youth organisations need to invest significant time and draw on specialist skills they may not have in-house. They also need to be able to project reasonably stable income streams to be attractive to social investors. This means that whilst capital investment may never have been more needed, expectations for the level of demand from the sector should not be set too high.

Scale versus sustainability. There is a mismatch between the kind of social investment available from the market today and the needs of the youth sector. The social investment market is focused largely on development capital to support investees to grow. The demand from the youth sector, however, is mainly for risk capital and transitional funding to allow them to shift from a grant-based business model to a revenue-based model. Commissioners and policy makers make this issue worse by expecting organisations to make a seamless transition from grant funding to a revenue-based model financed through social investment.

RECOMMENDATIONS

Commissioners and **policy makers** should:

- Involve youth sector organisations in the consultation process for prospective commissioning changes so that they can effectively plan and adapt to change.
- Recognise and plan for the investment readiness process to be a time and resource intensive process.
- Continue to provide grant funding for capacity building and investment readiness support in order to unlock the potential of social investment.
- Allow for a transition period to new commissioning/contracting environments.

Grant funders should:

- Provide financial and non-financial support for organisations to develop their strategic plans so that they can identify and develop truly sustainable and robust

business models. This needs to come prior to, and be more intensive, than traditional investment readiness support.

Social investors and intermediaries should:

- Presume a low level of knowledge and understanding of social investment within the sector.
- Recognise and plan for the investment readiness process to be a time and resource intensive process.
- Be as open as possible about risk appetite and what investors will and will not fund.
- Increase the transparency and publicity surrounding investment transactions and the investment readiness process.
- Raise the profile of youth sector organisations who have received investment, as ambassadors or mentors for other organisations thinking about social finance.

CONTEXT

Expectations surrounding the role that social sector organisations can play in delivering public services are high. The Prime Minister has said he wants *charities and social enterprises right to the fore in our mission to change this country.*[3] The 2013 Social Value Act and the localism agenda represent just some of the Government's attempts to open up provision of public services. The work that the youth sector does is critically important, particularly now. Social investment has been championed as a revolutionary new source of finance that will enable the social sector to take up this opportunity.

The problem for young people

Need is rising. Youth unemployment has remained stubbornly between 19-22 per cent of 16-24 year olds since 2009. Eight per cent of 16-18 year olds are not in employment, education or training (NEET). This represents 153,000 young people. The potential impact on the life chances for this generation could be huge. Research for the Audit Commission found that over the long-term, each young man who is considered NEET between the ages of 16 and 18 is four times more likely to be out of work, five times more likely to have a criminal record and three times more likely to have depression than his peers who remain in education and training.[4] Raising the participation age until which young people must continue in education and training to 17 from 2013 and 18 from 2015 will only go so far. Employers are dissatisfied with the education system's ability to prepare students for working life[5] and vocational education has been described as inadequate.[6] Alternative provision for those hardest to reach has been criticised as variable in quality[7] and a "flawed system that fails to provide suitable education and proper accountability for some of the most vulnerable in the country."[8]

What the youth sector does

Youth sector organisations are at the front line of services for young people – thousands of charities, social enterprises and local authorities run services for many thousands of young people each year. Informal education plays a fundamental role in building the social and emotional capabilities young people need to be resilient in the face of the above challenges. The employability skills that employers are so desperate for schools to prioritise,[9] such as self-management, team-working, problem solving and communication, are the bread and butter of the youth sector. The academic evidence concerning the correlation between these core skills and positive long-term outcomes is growing and gaining in credence.[10] Young people also see the link themselves. Ethnographic research in Camden 2012 found "it was

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[3] April 2nd 2012 speech at the launch of Big Society Capital http://www.number10.gov.uk/news/transcript-press-conference-launching-big-society-capital-at-the-london-stock-exchange/

[4] *Against all odds*, Audit Commission report, July 2010

[5] Education and Skills Survey 2012, CBI

[6] Review of Vocational Education: The Wolfe Report, March 2011

[7] Survey on Alternative Provision, Ofsted, July 2011

[8] Taylor Review of Alternative Education, March 2012

[9] The CBI's Education and Skills Survey 2012 showed that 71 per cent of respondents wanted secondary schools to prioritise employability skills

[10] *Framework of Outcomes for Young People,* Young Foundation, July 2012

often youth workers, as opposed to schools or careers advisors, that helped to signpost young people to career and employment opportunities."[11]

Youth projects offer an opportunity for all young people to develop the vital emotional and social capabilities they need to make the transition to successful adults. It is an important form of early intervention, addressing the concerns of those in town and village halls up and down the country who are concerned about a generation seen as at risk of exclusion. As the Government's statement, Positive for Youth sets out, youth workers:

> *can identify early any specific and complex problems for which young people need more specialist help. They can listen to young people, and build their confidence and skills to make their voice heard in decisions. They can relate to young people with respect while challenging them to take responsibility.*[12]

Pressures on the system

In the face of this rising need, the most recent figures released by the Department for Education in January 2013 showed that funding from local government for youth services suffered a 26 per cent cut from 2011 to 2012.[13] This downward trend is expected to continue. The Local Government Association (LGA) has forecast a further reduction in the funds available for non-statutory services (where most of youth support is funded) until 2020.[14] Unlike education, youth services have not been ring-fenced. As a result, youth services are now competing against other areas, such as children's services, for a diminishing pot of local authority money. These funding cuts have a knock on effect on the voluntary youth sector, which has traditionally relied on grants from local authorities for 'core' funding. One regional organisation we spoke to had lost 90 per cent of its local authority funding.[15]

The impact of funding cuts does not stop at a reduction in the amount of money available. The whole delivery of services has been shaken up, from *what* services are funded to *how* they are commissioned. Although the aggregate level of funding for universal services has remained static, the picture varies hugely between each local authority, with the same holding true for targeted support. In some instances, universal services have been entirely withdrawn and council youth services closed, while in others services previously commissioned have been brought in-house. Where services are commissioned out, there has been a move away from multiple, small-scale contracts to a handful of large ones. The indirect result of the procurement process can be that local organisations without a large balance sheet or the same capacity to take on risk as national private sector bodies are unable to compete and find themselves without a mandate or funding to deliver their core services.

Some in the sector are waiting for the tide to change and the funding tap to be turned on again. Yet when additional funding has been made available centrally, as with the £126 million Youth Contract to tackle young people NEET, it has increasingly been through payment by results (PBR) contracts. For a sector that has traditionally found evidencing outcomes beyond qualitative anecdotes challenging,[16] this has created a barrier to competing for contracts, and consequently a need for funding to introduce the systems, frameworks and

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[11] *An insight into the impact of the cuts on some of the most vulnerable in Camden*, The Young Foundation, July 2012

[12] Positive for Youth: A new approach to cross-governmental policy for young people aged 13 to 19. Department for Education, December 2011

[13] http://www.education.gov.uk/rsgateway/DB/SFR/s001114/index.shtml

[14] *Funding outlook for councils from 2010/11 to 2019/20 : Preliminary Modelling*, the Local Government Association, July 2012

[15] Survey of youth sector organisations Spring 2013

[16] *Framework of Outcomes for Young People,* Young Foundation, July 2012

training required. Where organisations are able to give evidence of their ability to achieve desired outcomes, the second hurdle of having enough cash reserves in place to cover the upfront costs and take on full operational risk means that they are unable to take on the contract.

How social investment can help

Social investment cannot compensate for reduced funding to deliver services. However, with the launch of Big Society Capital in April 2012 increasing the supply of social investment by approximately £600 million, it is not something that organisations can afford to dismiss too quickly. What is more, the supply of funds is rapidly escalating, with the Big Lottery Fund,[17] mainstream charities,[18] housing associations[19] and even investment banks such as Deutsche Bank[20] dipping their toes in. Initiatives from the Cabinet Office such as the Red Tape Challenge have already resulted in a commitment from Her Majesty's Treasury to introduce tax incentives for social investors in 2014, which could result in the supply of funds increasing by as much as £480 million over five years.[21]

It is not solely the volume of funds that is of relevance to the youth sector, but the fact that it represents capital investment which is otherwise scarce. At a time when funders are becoming more rigid about the proportion of budgets that can be allocated to overheads, organisations are constrained in their ability to generate their own surplus for reinvestment.

The impact priorities of social investors are heavily aligned with the work of the youth sector. Big Society Capital's outcomes matrix, part of its guidance for best practice in impact investing, focuses on areas such as employment, learning and skills, employment and training, personal and social wellbeing, all of which are core to support given to young people. For example, Bath YMCA's work to provide housing and support to homeless teenagers or Space 2, Newcastle YMCA's collaborative project with Northumbria University, to provide design and sales specific skills and work experience, both address outcomes set by Big Society Capital.

The state of play

The use of social investment can be separated into two categories. Firstly, it is used to provide capital investment into organisations with a sustainable revenue-based business model. There is limited public information about investment transactions. This makes it difficult to estimate the current level of investment in the youth sector, both in terms of monetary value and the number of organisations supported. The fact that the last detailed assessment of the market showed that only five per cent of investments were in the highly sought after, and much discussed, risk capital,[22] leads us to conclude that social investment is yet to play a dominant role in financing start-ups, innovation and scaling up, three of the four areas for potential we outlined in *Growing Interest*.

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[17] Big Lottery Fund's remit was extended in May 2012 to include social investment

[18] In November 2011 the Charities Commission issued CC14, Charities and Investment Matters: A guide for trustees

[19] London housing association L&Q has committed £10m to setting up a social investment fund

[20] Deutsche Bank launched a £10 million Impact Investment Fund in November 2011

[21] *The role of tax incentives in encouraging social investment*, City of London, Wragge & Co, Worthstone, March 2013

[22] *Lighting the touchpaper, Growing the Market for Social Investment in England*, Boston Consulting Group. The Young Foundation, Nov 2011

Where information is available, for example in CAF Venturesome's report on the first year of its Social Impact Fund, these are predominantly to meet working capital needs rather than to fund innovation or growth.[23] Bridges Ventures' £450,000 investment into Auto 22, a social enterprise subsidiary of Catch 22, is one of the few examples of risk capital being deployed.

The second category is providing the upfront financing for outcomes-based contracts, for example through a social impact bond. The picture for outcomes-based contracts is quite different. Increasingly, public sector service contracts are being commissioned through payment by these means. In programmes such as the DWP Innovation Fund targeting youth unemployment, securing support from a social investor was a prerequisite. In others it can be a by-product of the fact that a proportion of the contract is paid in-arrears. As these payments can be scheduled anything between three to 18 months after the intervention has been delivered, social investors are often a key source of the working capital needed to cover the upfront costs of the intervention. Recipients of such investment include Teens and Toddlers, Dyslexia Action, Greater Merseyside Connexions Partnership and Tomorrow's People, all via the DWP Innovation Fund[24], and Action for Children, which is providing support to 380 11-16 year olds and their families as part of Essex Council's £3.1 million social impact bond.[25]

Realising the potential

In the face of what may seem to be slow progress, it is worth remembering that social investment is still a relatively immature market. Although Big Society Capital has already committed £52 million to 20 intermediaries[26], with the exception of the social impact bonds, this largely represents the capitalisation of intermediaries, and is one step removed from the money being received by ventures on the ground. Meeting social objectives is only one aspect of securing investment. Organisations need to offer an investible proposition in their own right. Since 2012, over £30 million has been earmarked to support social sector organisations to become investment ready. With the Cabinet Office's £10 million Investment and Contract Readiness Fund (ICRF) and £10 million Social Incubator Fund, as well as the forthcoming £10 million investment readiness fund from Big Lottery Fund, all committing financial and non-financial support, 2013 is being talked of as the year that the potential begins to be realised.

LESSONS IN INVESTMENT READINESS

As the sole investment readiness programme targeting the youth sector, Catalyst had an important role in helping the sector realise the potential of social finance. The programme was conceived in mid-2011, before the launch of cross-sector programmes such as the Investment and Contract Readiness Fund and with a fraction of the budget. The programme had two core aims: firstly, to raise awareness of social investment across the youth sector and secondly to support individual organisations on their journey to securing investment.

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[23] *CAF Social Impact Fund: Full Year Report July 2011-June 2012 ,* CAF Venturesome

[24] http://www.dwp.gov.uk/supplying-dwp/what-we-buy/welfare-to-work-services/innovation-fund/

[25] http://www.bridgesventures.com/investment/action-children

[26] Press release 15 January 2013 http://bigsocietycapitalblog.com/2013/01/15/big-society-capital-ceos-outlook-for-2013/

More need than we thought

Twenty per cent of the organisations surveyed in 2011 expected to be using social investment by 2014.[27] From the evidence of the *Growing Interest* report, it did not seem overly ambitious to expect that, through targeted support, the Catalyst programme could enable 20 organisations to access social investment. From the outset there was an expectation that the level of support required would be short and sharp, akin to a strategic nudge to unlock the investment opportunity.

However, we found that probing under the surface of an outwardly successful organisation – with a strong track record of delivering positive outcomes – often revealed cracks in the strength of their investment readiness. More often than not, this manifested itself in an inability to specify the amount of funding needed and a detailed plan for how it would be used and how it would be repaid. This echoes the conclusions of New Philanthropy Capital and Clearly So in their report, *Investment Readiness in the UK*, that "those organisations that were not successful in securing finance may have sought it too early before establishing and/or presenting these features [sustainable business model and suitable financing option] convincingly".[28]

This experience informed our approach to delivering the programme. Instead of one-to-one support with a handful of organisations, we sought to address the root causes of this lack of investment readiness. Namely, these were misconceptions about what investment readiness means and the lack of a detailed strategic plan on which to base the investment proposition.

Framework

Our approach was based on a framework known as Maslow's four stages of competence, which breaks down the process of learning a new skill into four distinct stages. Firstly, being unaware of what you don't know ('unconscious incompetence'); secondly, being aware of this gap but unsure how to address it ('conscious incompetence'); thirdly, actively working to acquire the skill ('conscious competence'), and the final stage when the skill has become second nature ('unconscious competence'). We used this framework to break down the process organisations go through to access investment, from being unaware of social investment, to not knowing what is needed to become investment ready, through to actively building the capacity required and finally being investment ready. The table below describes the typical characteristics of an organisation at each stage.

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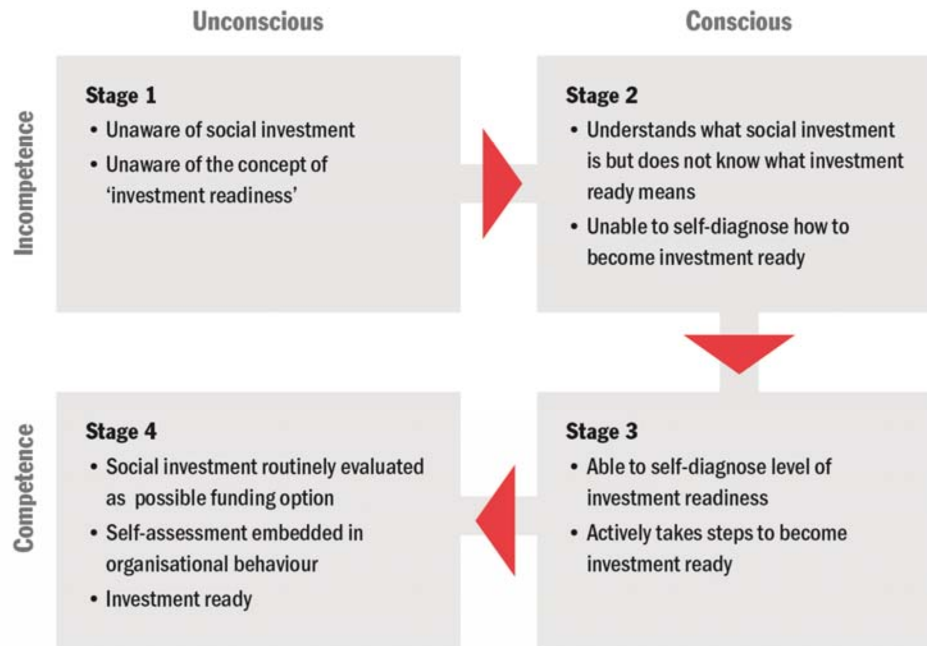
[27] *Growing Interest: Mapping the market for social finance in the youth sector*, The Young Foundation, July 2011

[28] *Investment Readiness in the UK,* New Philanthropy Capital and Clearly So for Big Lottery Fund, July 2012

Table 1. Characteristics of organisations at the four stages of becoming investment ready



Source: The Young Foundation, based on Maslow's Theory of Competence

Investment readiness in four steps

What we delivered

The Investment Readiness programme ran from October 2011 to March 2013 and involved a combination of introductory workshops, masterclasses and one-to-one support and advice.

1) Introductory workshops

This interactive session targeted organisations in the first two stages of investment readiness, to address four key issues:

- defining social investment and understanding its relevance to the voluntary youth sector
- assessing when social investment is appropriate and what tools to use
- identifying social investors and understanding what they look for
- assessing an organisation's investment readiness

We ran 23 sessions across England in places as far afield as Penrith, Bradford, Toxteth, Sheffield, Coventry, Birmingham, Chippenham, Plymouth, Reading and Worcester. These events were run with the National Council for Voluntary Youth Services, regional infrastructure bodies and regional youth work units to ensure we had maximum reach. Over 350 individuals took part, from youth workers, managers and directors of charities, social enterprises and infrastructure bodies through to local government commissioners and central government officials.

2) Masterclasses

We ran two sets of masterclasses with 16 organisations to provide them with the tools and space to:

- identify their funding needs
- assess their investment readiness needs
- meet investors in an informal environment

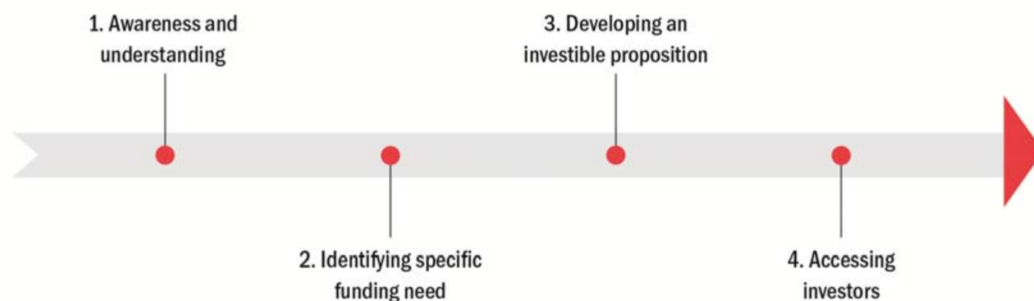
Over the course of four days participants worked with specialists to map out their social business model canvas, evaluate their theory of change and identify their strategic priorities. This lead on to identifying corresponding financing requirements and using an organisational health scorecard to assess their investment readiness. The course ended with an overview of the legal implications of investment and a question and answer session with social investors.

3) One-to-one advice

Complementing the formal group learning sessions we provided one-to-one support and advice to over 20 youth sector organisations.

Drawing on this framework, we defined key objectives for each stage, which we describe as the four steps for securing social investment. The content of the programme is summarised in the box below. Observations based from our work at each stage are then explored in detail.

Figure 1. Four stages of investment readiness



1. Awareness and understanding

For many this is about moving from unconscious to conscious incompetence, through a Social Investment primer. As one participant described, "I came to this thinking I knew what social investment was for, but you don't know what you don't know."[29] Although good sources of information are freely available,[30] misconceptions persist about what social investment is and how it is used. A frequent belief we came across was that the results of a

[29] Source Investment Readiness programme feedback

[30] Best to Borrow, NCVO http://knowhownonprofit.org/funding/social-investment-1?gclid=CMGPvcevkLYCFcrHtAod71UAEg and Social Finance http://www.socialfinance.org.uk/resources/social-finance/payment-results-youth-sector

Social Return On Investment (SROI) calculation is equal to the financial return sought by an investor. These are relatively easy misconceptions to correct. However, the fact that 30 per cent of organisations who said they were ready for investment, also defined investment as a form of grant or philanthropy (in a survey we conducted to assess levels of understanding of social investment), highlights the importance of this issue.[31]

More difficult to overcome is the belief that investment is inappropriate for a social sector organisation. The concept of a not-for-profit organisation generating a profit (ie, a surplus), let alone provide someone else with a financial return, does not sit comfortably with a sector that has traditionally been funded through public sector grants that have rarely allowed for full cost recovery. At the most extreme, one participant stated, "I'd rather dissolve my organisation than take on social investment."[32] Others were genuinely unsure of how to view it: "Is social investment ethically sound?,"[33] or "What liability will or should my trustees take?"[34]

2. Identifying specific funding need

Organisations that are seeking social investment often assume they are somewhere between stage 3 (developing an investible proposition) and stage 4 (accessing investors). While able to discuss at a high level their plans for expansion or development of a new service or product, probing a detailed plan too often results in an uncomfortable look or a dismissive "I haven't had time to work that out."[35] In reality, they are positioned somewhere between stage 1 and stage 2 – for the most part they understand social investment, but do not have a detailed strategic plan which shows where social investment would fit in and how much is needed.

The organisations taking part in our masterclasses were all considering applying for social investment to fund growth or development of a new service. Not all had a detailed plan or strategy in place for delivering this growth or venture, and fewer still had detailed and evidenced financial projections underpinning the plan.

We found many organisations needed to go back to first principles in order to get answers to the questions:

- How much funding do you need?
- What will it be spent on?
- When will you need it?
- How and when will you repay it?

This involved more fundamental planning about the organisation's strategy:

- What is the organisation's vision?
- What is the strategy for achieving this vision (ie, how do you plan to do this over the next one, three and five year period)?
- What financial and non-financial support is needed to achieve this, and when?

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[31] We surveyed the awareness of social investment in Spring 2012, n=23
[32] Source Investment Readiness programme feedback
[33] Source Investment Readiness programme feedback
[34] Source Investment Readiness programme feedback
[35] Source Investment Readiness programme feedback

Malachi, a community interest company providing specialist family support, found that "being able to map out our services and how they all link back to our logic model and overarching vision has helped us clarify and consolidate our development plan. It sounds simple but we hadn't had the opportunity to do this before."

We also came across a second group of organisations who were in survival mode and saw social investment as a possible saviour. We met many charities and social enterprises whose main sources of funding, predominantly local government or schools, had dried up in a short space of time. They knew they had to adapt to survive and that social investment could enable them to do this, however they did not know how or where to start.

The time needed to work through this stage should not be underestimated and while it is an essential part of securing investment, is integral to the leadership of any organisation, whether it is seeking investment or not.

3. Developing an investible proposition

At this stage the internal strengths of an organisation's confidence, capability and capacity, highlighted in *Growing Interest*, come to the fore. An investible proposition requires:

- *Confidence* over future revenue streams. What are the assumptions underlying the financial forecasts? How are these evidenced? Have these been stress tested for worst-case scenarios? Does the competitor analysis and market positioning support the expected income growth?

- *Capability* to articulate the positive impact on young people. In particular, how will this change as a result of investment and the strategic direction the organisation has chosen?

- *Capacity* to acquire and embed the skills needed for the business model to be investible.

We found that it was the third element, capacity, that was the deciding factor in achieving an investible proposition. The obvious assumption is that charities are let down by their internal capacity and capability, a lack of business acumen, non-charity experience and management skills. The indirect cause of these deficits is a lack of financial and human resources to invest in expertise. Capacity constraints meant they are unable to prioritise building the business case and financial projections over the day-to-day running of the organisation. Young Bristol has been forced to put its development plans on hold since local commissioning changes resulted in them absorbing three affiliate organisations and committing to fund a further five who have collectively lost £135,000 of annual core funding.

What is meant by a compelling business case and the level of detail expected, for example substantiating forecast revenues with analysis of competitors, market pricing strategies and different growth scenarios, came as a surprise to many participants. This is in contrast to many grant or tender applications where awards are made based on the analysis of a written application that is often word-limited and excludes financial projections. As frustrating as this stage is, this is one that often filters out those who are not ready for the rigours of taking on investment.

Becoming 'investment ready': five case studies

The five examples below illustrate the diversity of organisations in the youth sector who took part in the masterclasses and have been evaluating social investment.

Bath YMCA aims to be an innovative social enterprise that anticipates, identifies and

responds to changing community needs. In Bath they have designated 18 beds in their 200-bed hostel, to support young people in need of a safe temporary place to stay. Having merged with Bristol YMCA in early 2012, they would like to replicate this model in Bristol, providing emergency accommodation and working with partners to facilitate effective assessment of needs and mediation with families. Since 2012 they have managed a commercial café within the Bristol Myplace development, the Station, which provides young people with work experience and skills development. They have been evaluating social finance as a potential source of financing to buy a hostel in Bristol and support the expansion of their café.

Humanutopia is a social enterprise that works in schools to enable young people to develop life skills to enable them to realise their potential. The Heroes journey uses peer mentoring to create positive role models within schools, fostering a positive and supportive community and addressing bullying. Humanutopia was founded in 2004 and has since worked with over 120,000 young people. Humanutopia wants to enable its apprentices to spread its work through a social franchising model, whilst establishing the Heroes journey as a nationally recognised award. Having successfully sold its services to schools in its first seven years, since 2010 school budget cuts have affected Humanutopia's sales. To access the social finance they need to grow, Humanutopia is having to reassess its overall business model and alternative revenue sources. It has also been seeking legal advice on its legal structure – though it has a social mission, it is a company limited by shares without an asset lock.

Newcastle YMCA provides support to young people in one of the most deprived areas in the country. The area has traditionally suffered from high unemployment and low levels of social mobility, which has increased over the last few years. In addition to open activities, the YMCA also delivers a range of targeted projects including alternative education, detached youth work, support to young mums and NEET prevention. To respond to the need for employability skills and work experience, the YMCA has been working with the University of Northumbria to develop an employment programme for young people that will involve designing, manufacturing and selling fashion items. Two smaller pilot projects have taken place involving 10 young people. They are considering social investors to provide risk capital to finance the development costs of embedding and growing this project.

The North East Regional Youth Work Unit (**RYWU-NE**) works across the North East of England to improve the lives of young people by promoting and supporting youth work and is one of six regional youth work units in England which act as a hub for youth work. As with many charities, funding has traditionally come from a variety of public and charitable bodies. The RYWU-NE has been established in the region for over 20 years and during the first 15 years its major source of income was local authorities through a central service level agreement (SLA). However, public sector cuts and changes to commissioning strategies saw the number of local authorities contributing to this SLA reduced from 12 to 6 in 2012. Moving forward into 2013 this figure has reduced further to the point where it is highly unlikely that any income will be received via local authority SLAs. In response to this the RYWU-NE has diversified its income streams in recent years and has developed project specific partnerships with local universities and research institutes as well as securing grants from charities such as the Co-Operative Foundation. It has also taken a strategic decision to move into direct delivery of youth programmes and offer consultancy support and independent brokerage. In 2013 it expects this to generate over 15 per cent of its total income.

Young Bristol is a youth-driven charity that works to offers a choice of opportunities and experiences for all young people. One area of its work is in the provision of outdoor activities. In 2012 Young Bristol was granted the lease of a piece of woodland just outside Bristol, where it has invested in a high ropes course. This area was used as a base for delivering the National Citizenship Service programme in 2012 and is now a core part of Young Bristol's offer. Young Bristol has been considering social investment to finance further development of the site and offer a climbing wall and archery range. Young Bristol sees partnering with a social investor as a way to share the risk of the investment. Up until the change in commissioning strategy in 2012, Young Bristol was contracted directly by the City Council to deliver universal services to young people. Following this change, Young Bristol has had to prioritise fundraising to support the work of its affiliate clubs across the city.

4. Accessing investors

The term social investor is abstract and covers a multitude of different organisations, individuals and motivations. Navigating who to talk to and when to engage can be confusing. This is in spite of the mass of publicity surrounding social investment and transparency with which investors normally set out their eligibility criteria and application process on their websites. Less than 30 per cent of the 23 youth sector organisations surveyed in 2011 had heard of Social Investment Business and less still (under 15 per cent) had heard of Clearly So, despite both being key primary access points for social investment.

Introducing participants to investors from CAF Venturesome and Big Issue Invest in an informal environment as part of our masterclasses helped humanise the perception of social investors. One participant summed it up as "very encouraging and refreshing to listen to an organisation that lends money that understands the sector's needs and is supportive in the way it invests". The fact that 'why should I use social investment' remains an issue for many youth sector organisations, highlights why creating an opportunity for them to meet investors early on in their thought processes can be a strong tool for unlocking latent demand. It also helps with understanding the timeline and when to make first contact, giving organisations the confidence to make that first call and begin discussions. For Malachi, this emphasised the responsibility organisations have to take for themselves in seeking out the right investor to meet their support (financial and non financial) needs.

KEY CHALLENGES

It is clear that youth sector organisations need financial support. Inherent challenges beyond a lack of investment readiness influence the extent to which social investment is able to meet this need.

Unlocking latent demand

Not every youth sector organisation will have a sustainable revenue-based business model, or be looking to enter into a payment-by-results based contract. As a result, taking on social investment will not be appropriate in every case. However, the sector is under extreme pressure. What was a sustainable model five, or even two years, ago does not necessarily hold

true today. Organisations have to adapt and where they have a clear plan in place for this, social investment could provide the financial lifeline needed to survive through the transition period. However, the suspicion about social investment may be preventing organisations from making informed decisions over as to whether social investment is an appropriate option. At the extreme, dismissing investment outright risks affecting not just the organisation, but ultimately the young people they are there to support. The issue affects organisations not in crisis mode. When we asked how they would finance future capital investment only 17 per cent of organisations surveyed in Spring 2013 said social finance while 67 per cent said grants.[36]. If an organisation has sufficient access to capital to finance its growth there is no need for them to take on investment for the sake of it. In this instance, organisations that prefer to grow organically may be restricting their growth potential or failing to take advantage of a funding stream that would allow them to be more resilient to future funding changes.

Unlocking this latent demand requires addressing the root causes of their suspicion and unease. This is more deeply rooted than a simple lack of knowledge. There is a cultural view that debt finance is inappropriate for a charitable organisation; suspicion that social investors are capitalists searching for a new market to make money in; fear that delivering a financial return compromises social aims; and the downside risk of an investment going wrong is seen to outweigh the upside of long-term sustainability.

Combating these issues requires a cultural attitude change that is then translated into behavioural change. This change needs to be effected and have buy-in at all levels: from youth workers to charity leaders, finance managers and fundraisers through to trustees. Change will not be achieved by social investors and intermediaries alone. Youth organisations that have used or evaluated using social investment have a key role to play in sharing their experience more widely and humanising the process. The greater the transparency over transactions and decision processes the easier it will be to counter sector misgivings.

Rapid pace of change in the external environment

There is an inherent tension between the pace at which commissioning and funding environments are changing and the pace at which youth organisations are able to adapt. Whether contracts are moving to a payment-by-results basis or being withdrawn completely, the notice period, typically of three months, is not enough for organisations to adapt to change. It can take considerably more time to develop the evidence needed to show a track record of delivering the commissioned outcomes. Similarly, identifying alternative forms of revenue and a plan to access them is a time and resource intensive process. Both of which are the starting point for developing the investment case to present to a social investor.

Becoming investment ready is a far more complex and involved process than many openly acknowledge. Even when an organisation has the time and internal capacity to build the internal expertise and develop a robust investment case, this can involve months of work. If the starting point is more fundamental strategic planning and modelling, as is the case for many in the sector, it will be far longer.

As has been repeatedly stated here, social investment is not a replacement for grant funding. Commissioners should not expect or assume that charities and social enterprises in the youth sector will be able to replace lost revenues through investment. If the youth sector is

[36] N=24

expected to maintain its level of support for young people then commissioners and policy makers need a more nuanced understanding of the complexities of developing a sustainable business model for a youth sector organisation. Pre-investment and contract readiness support is needed, which is not readily available. Nor is it the gap that social investment is currently looking to fill.

The lack of investment in the sector is not a sign that it is irrelevant or of failure. It reflects the complexities of introducing and embedding business practices, such as long term strategic planning, into the sector. As a result, there is a need to adjust expectations for the pace at which social investment in the youth sector can realistically grow.

Scale versus sustainability

The third challenge is between the capital needs of the youth sector and the targeted uses of social investment. Rhetoric within the social investment market focuses in on it as a tool for financing innovation or scaling up. Investors want to be the catalyst for systemic social change. At the launch of Big Society Capital, the Prime Minister focused on *investment for expansion into the wider region and into the country.*[37]

However, the reality is that a large proportion of youth sector organisations need investment to sustain their current level of delivery. For these organisation their ambitions for growth may be aspirational rather than an immediate priority. This begs the question, is the funding that organisations need really what investors are willing to give?

When the social investment market was originally conceived the largest funding gap for charitable organisations was for development or growth capital. It was designed to support the few organisations who, had they operated in the private sector, would have had the potential to grow and operate nationally.

Unfortunately, the rise in supply of social investment has coincided with a decrease in public sector grants. Grant funding covers a fraction of what it did during the first decade of social investment. As a result, many charities and social enterprises have to look for alternative sources of revenues to ensure their sustainability. The funding needed to support this is not what social investment was designed for. It is higher risk and more suited to grant or philanthropic support.

In the light of this mismatch, the onus is on the investment sector to be more realistic and honest about what it will fund. Otherwise we risk sending too many organisations down rabbit holes, when they could be looking at alternative ways to become sustainable. Greater openness and transparency will help manage expectations on all sides, including investors and policy makers as much as charities and commissioners. It will also help to ensure that striving for innovation does not come at the expense of sustaining support for young people.

CONCLUSION

It is still early days for social investment and the additional funding that is being channelled into supporting social sector organisations become 'investment ready' is welcome.

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[37] April 2nd 2012 speech at the launch of Big Society Capital http://www.number10.gov.uk/news/transcript-press-conference-launching-big-society-capital-at-the-london-stock-exchange/

Was our assessment of investment readiness needs correct?

The youth sector is undergoing a major shift, from being reliant on multiyear programme grant funding to a world where funding is less plentiful, more volatile and where performance is scrutinised more closely.

The organisations mentioned in this report, highlight the promising opportunities for social investment to support growth and impact in the youth sector.

Overall, however, the youth sector has more to do in developing strong, well governed organisations with robust strategies to deliver their vision, and the underpinning financial health and stability to do this.

Is social investment living up to its potential in the youth sector?

Seeking social investment is not an appropriate response to a funding crisis and nor can it replace programme grant funding. This is not fully understood by commissioners nor the sector itself. What it can help with is a transition from a largely grant-funded model to a more revenue-based model where the opportunity exists to make this transition. It can also play a role in providing development capital to revenue-based organisations who want to grow.

Progress has been quicker in supporting payment by results programmes than in the provision of development and growth capital, although even here the number of organisations benefiting remains small.

Adapting to these changes is a slow and iterative process, requiring higher risk capital than currently on offer in the social investment market.

However, there is cause for optimism about the potential for social investment to become a major source of capital funding for youth sector organisations.

What lessons have we learned?

It is a comparatively long road to get organisations to a point at which they can access social investment. This requires less traditionally conceived investment readiness support, which tends to provide a short intervention to cover the 'last mile', and deeper capacity building programmes.

Recommendations

Commissioners and policy makers as well as grant funders, social investors and intermediaries all have a role to play in ensuring that social investment realises its potential. Recommendations for these actions are summarised below.

Recommendation	Audience
Presume a low level of knowledge and understanding of social investment within the sector.	Commissioners, policy makers and social investors.

Provide financial and non-financial support for organisations to develop their strategic plans so that they can identify and develop truly sustainable and robust business models. This needs to come prior to, and be more intensive, than traditional investment readiness support.	Grant funders.
Recognise and plan for the investment readiness process to be a time and resource intensive process.	Commissioners, policy makers and social investors.
Raise the profile of youth sector organisations who have received investment, as ambassadors or mentors for other organisations thinking about social finance.	Social investors and youth sector organisations.
Increase the transparency and publicity about investment transactions and the investment readiness process.	Social investors.
Involve youth sector organisations in the consultation process for prospective commissioning changes so that they can effectively plan and adapt to change.	Commissioners and policy makers.
Continue to provide grant funding for capacity building and investment readiness support in order to unlock the potential of social investment.	Commissioners and policy makers.
Allow for a transition period to new commissioning / contracting environments.	Commissioners and policy makers.
Be as open as possible about risk appetite and what investors will and will not fund.	Social investors.

Next steps

Following on from the investment readiness programme, The Young Foundation has published an introductory guide to social investment, including a short animation, for those working in the voluntary youth sector, from youth workers to trustees. The Young Foundation is also supporting youth sector organisations in a number of ways. The Young Foundation's Accelerator programme continues to work with early stage organisations who are aiming to secure social investment and/or commissioned work and continues to support organisations making the shift from grant dependency to revenue based business models, for example through our Better By Design programme funded by BIG Scotland.

The launch of programmes such as the Investment and Contract Readiness Fund and Big Lottery Fund's prospective investment readiness fund are well positioned to support organisations at the stage of developing an investible proposition. The financial and non-financial support their grants provide will enable more voluntary youth sector organisations to access investment and capitalise on the opportunity that social investment presents.