

DIRECTORY OF SOCIAL CHANGE

INFORMATION AND TRAINING FOR THE VOLUNTARY SECTOR

**DSC response to the Social Investment Wholesale Bank
consultation**

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About the Directory of Social Change

The Directory of Social Change (DSC) has a vision of an independent voluntary sector at the heart of social change. We believe that the activities of charities and other voluntary organisations are crucial to the health of our society.

Through our publications, courses and conferences, we come into contact with thousands of organisations each year. The majority are small to medium-sized, rely on volunteers, and are struggling constantly to maintain and improve the services that they provide.

DSC is not a membership body. Our public commentary and the policy positions that we take are based on [clear principles](#), and are informed by the contact that we have with these organisations. We also undertake [campaigns](#) on issues that affect them or which evolve out of our research.

DSC views its role as that of a 'concerned citizen', acting as a champion for those smaller organisations whose needs may not be accounted for in public policy. We ask critical questions, often challenge the prevailing view, and try to promote debate on issues that we consider to be important.

DSC's general reaction to the consultation

We think that the idea of social investment has some merit in particular circumstances, and the consultation usefully sets out some different examples. Clearly it can help organisations to diversify income streams, develop new services or acquire much-needed facilities.

However, we do not view social investment as a substitute for more traditional forms of funding such as grants. Our main concern is that in the current policy debate social investment is being portrayed by its proponents as the 'fix-all' that will remove the need for some form of subsidy for those organisations which operate in areas of so-called 'market failure'. Whether for charities or indeed even for social enterprises, we think this is unrealistic.

Further, the idea of social investment and its relative merits or uses is not the same thing as a Social Investment Wholesale Bank (hereafter, 'the Bank'). Despite all the discussion about the Bank in recent years, we do not believe that there is sufficient evidence of need for such an institution, or of un-met demand for the services it might provide.

In short, we think there are real problems with this proposal, namely that:

- There is little evidence of need for an institution of this type, and for the type of finance it might provide, from the vast majority of voluntary and community organisations;
- There is little evidence that the existing provision of social finance has been analysed sufficiently, let alone a robust conclusion that the current marketplace is not sufficiently developed to meet demand;
- The planning and the timing of the consultation appear suspect, in light of the political situation and upcoming election;
- It is very unclear what outcomes the Bank is intended to achieve, how its performance might be measured, or even how it would demonstrate 'value for

money', a characteristic of too many recent large-scale Government policy initiatives;

- There is no obvious source of capital for the Bank, effectively putting the cart before the horse, since the Government has decided to prioritise funds from dormant accounts for other purposes;
- The proposal is rife with arrogant and condescending phrasing which illustrates a profound lack of understanding of the voluntary sector, and which demeans the skills and intelligence of the millions of citizen volunteers who enable voluntary organisations to function.

Running throughout this consultation is the assertion that the third sector is 'chronically undercapitalised', and that this is the core problem which the Bank is supposed to address. However, there are a number of problems with this, namely:

Lack of evidence – the assertion that the sector is 'undercapitalised' and that a social investment bank is the solution to that perceived problem is not based on solid evidence of need or demand for more finance or capital. The consultation cites the 2007 *Third Sector Review* as evidence, and states that 'access to appropriate funding *and finance* often remains the single biggest concern facing organisations'.

Looking at the official writeup of responses to the review (not the review document itself) it is clear that the consultation process certainly raised *funding* as one of the most important issues, but not *finance*. A quick search of terms in this document reveals that:

- 'social investment bank' does not appear
- 'social investment' does not appear
- 'social return on investment' does not appear
- 'loan(s)' does not appear
- 'equity' appears once, in a section on social enterprise
- 'finance' appears 4 times, mostly not in the context of investment
- 'funding' appears 55 times
- 'grant(s)' appears 18 times

In fact this simple search would seem to indicate that if anything there is little support for financial investment as opposed to traditional grant funding in the sector. There are good reasons for this which the Government ignores at its peril. The bizarre proposal in the consultation that the Bank should help *stimulate demand for finance in the sector* shows a very circular logic at play.

Lack of understanding of the sector – the tone of the consultation implies that the 'undercapitalised' nature of the sector is somehow an irrational situation. It conveys an ideological view that not-for-profit organisations *should* be in the business of accumulating capital, so they can expand their services (including, it follows, by putting competitors out of business). It largely ignores key facts, such as:

- Legal structure and purpose – charities in particular are not set up to accumulate capital and wealth, they are there to serve social needs. If their 'undercapitalisation' is in fact a threat to their sustainability, surely better regulation around reserves policies, and raised public awareness about why reserves were needed, is the answer – not a social investment Bank.

- Limited opportunities for income generation – many charities work in areas of ‘market failure’; expecting them to generate sufficient income to support loan repayments is simply counter-intuitive, even if it can work in certain circumstances. The broad scepticism of many trustees about loan finance is not misplaced or erroneous as the consultation implies – in fact it is just common sense and a sign that trustees are doing their job properly.
- Growth is not the objective – most organisations in the sector are not necessarily interested in growing and expanding. They are locally-focused and supported by citizens who work in and for their own communities. A market logic of accumulating capital in order to expand into other areas, creating economies of scale, outperforming competitors, leading to more profits and greater capital accumulation, is not consistent with an ethos of locally-supported, cooperative voluntary action.

Viewing the sector mainly in terms of its potential to deliver government policy – the overall tone of the consultation assumes that the sector exists to serve certain ends, namely ‘social and economic regeneration’. This attitude is fundamentally flawed but unfortunately characteristic of much government policy. Ending the situation of supposed ‘chronic undercapitalisation’ is part of an agenda to organise, rationalise, and marketise the sector so that it is better placed to do what government wants it to.

Responses to the consultation questions

1. Do you agree with the vision for a Social Investment Wholesale Bank (SIWB) set out in this consultation?

DSC’s view is that the entire concept of a social investment Bank that would facilitate finance for charities has significant flaws, apart from the flaws in the Government’s ‘vision’ as presented in the consultation. We have outlined these above. There may be merits to social investment but in our view these are quite limited and will not be relevant to the vast majority of voluntary organisations.

Further, the current rhetoric about the potential of social investment to solve all social problems (including, conveniently, the coming cuts in public spending it would seem) is in our view totally overblown and even dangerous.

2. Do you agree with the economic case as it is set out, and do you have further evidence, case studies or detail in its favour or evidence to the contrary? To what extent does the evidence suggest problems are short term (for example, linked to the immaturity of the market or perceptions) or intractable?

We think the economic case has not been made. In fact, we are astonished that this proposal is even on the table, at a time when malfunctioning capital markets have plunged the entire world economy into recession, resulting in the nationalisation of huge banks by the governments of the world, massive public debt, and impending cuts in public spending. The idea seems to have been resurrected mainly as a way to allow Government to reduce its spending on the voluntary sector in the future era of austerity.

This proposal also typifies a kind of phony-market philosophy that is characteristic of much recent government policy – it aims to tap into the power of the free market, but ignores fundamental market laws. It argues that the state needs to intervene to develop and organise the market in social finance, which ignores the fundamental principle that markets will develop what is needed in response to demand. Worse, it argues that demand needs to be stimulated – created, in fact – by convincing people (trustees) that social investment is what their organisations need, even though they may have very valid reasons why they are not interested in it.

3. There are five potential functions for the Bank outlined in this consultation:

- **a champion for sustainable social investment;**
- **raising capital;**
- **investing and providing capital;**
- **market-making; and**
- **advisory services.**

If a Social Investment Wholesale Bank is created, its functions should be limited to the second, third and fifth functions. The other two are in our view perverse.

If the Bank is charged with being a ‘champion’ for social finance this is inherently dangerous. Even if it acts independently of government – which is very difficult to believe – it will still be a government-founded and government-funded mechanism promoting a particular ideology, with a mission to ‘transform’ the voluntary sector and wider civil society so that it better serves the needs of the state. This amounts to an abuse of the idea that individual citizens have democratic rights, and makes a mockery of other government policy which purports to enhance citizen and community ‘empowerment’.

As stated above, we think that trying to organise markets through state direction is contradictory to the principles of free market economics, and therefore baffling in this context. Of course the state plays an important role in regulating markets, but that is not the same thing as ‘market-making’.

Are these an appropriate response to best address the problems identified? If so, why? If not, why not and what are the alternatives?

We don’t think the ‘problems’ have been properly identified anyway. Throughout this consultation and in other documents about the Bank there is an assumption that the voluntary sector is ‘chronically under-capitalised’, which is the reason given for needing a Bank. This assertion is flawed on many levels, not least in that it is not the purpose of charities in particular to accumulate capital in order to grow – their purpose is to serve social needs. Accumulating capital may enable a charity to better serve its beneficiaries or it may not. Therefore assessing whether the Bank is the appropriate response to this supposed ‘problem’ is a moot question.

4. Each potential function will have costs and benefits over time (both direct and indirect, social and financial). What is your view about these costs and benefits, and what evidence is there to back this up?

As we have stated above, we don’t think that the first and third functions should be considered; therefore the associated costs are not relevant in our view.

The overall costs of running the Bank, the costs of maintaining and growing its capital base, and the costs to existing providers in the emerging marketplace of social finance are what really need to be considered here.

It is hard to see how an institution with sufficient size to make the intended impact could be sustainable without damaging the market it is supposed to support. How would it balance the need to maintain and grow its capital with inherently higher levels of risk? Although it would be the 'lender to the lenders', the ultimate beneficiaries of such finance will be organisations that for one reason or another are operating in areas of 'market failure' – social causes or geographical areas where making money is hugely difficult, risk of failure is high, and in most cases there will always be a need for some level of subsidy from somewhere to make the numbers add up.

As Charity Bank has pointed out, it is hard to see how the Bank could both maintain its capital base and facilitate lending to inherently risky ventures without selling its own products and services. If that were the case it would become a government-created competitor to existing providers. That would pose a risk to the developing market.

Further, it is obvious that the newly rebranded 'Social Investment Business' is positioning itself to run the Bank. They have an openly stated strategy to create a £1bn investment fund, which they argue will allow them to lever in money from mainstream markets and so 'transform' the voluntary sector. Creating a fund of this scale (almost entirely with government money) is an obvious threat to the development of the emerging market as many of the funds administered by SIB will already be competing for the same relatively limited number of customers as other providers.

5. Should advisory services for front-line third sector organisations and social investment intermediaries accompany the provision of capital or be provided separately?

If the Bank is created it will need to provide advisory services for front-line organisations in an accessible, helpful and *impartial* way, whether with provision of capital or separately. The Bank should NOT be engaged in trying to convince organisations of the value of social finance.

6. When raising capital, what combination of social and financial risks and returns would be attractive to investors? What evidence is there that the Bank could attract investment on these terms, from whom and through which investment products?

Rather than just focusing on risks and returns, the Bank must consider the social and environmental values of that capital investment and the investors providing it. Principles of ethical investment need to be absolutely at its core. If, for example, the Bank were to distribute capital invested by multinational companies which oppress workers in the developing world, this should be ethically and morally counter to its aims. In effect that investment would be debiting the 'social value' of oppressed workers in other countries in order to create social value in the UK, which would be profoundly wrong.

7. When providing capital, what combination of social and financial risks and returns would the Bank offer? What evidence is there that the Bank could make investments on these terms, to whom and through which investment products?

We cannot provide a view at this time.

8. Which combination of functions would be most effective and deliver best value for money?

We cannot provide a view at this time.

9. Do you agree that eligibility should be based on potential social and environmental impact, rather than defined by legal or organisational form? If so, would it be necessary to ensure that the Bank ultimately supported a diverse range of enterprises, for example small, black and minority ethnic-led and rural projects?

An example of the utterly arrogant and condescending language in the consultation bears mention here: 'the third sector exists only to help its beneficiaries and to deliver social change. It is not an end in itself.' In a free society, it is not government's job to tell individual citizens who freely support organisations and causes for any number of reasons, what they exist to do. Quite the contrary – it is for those citizens to tell government what it exists to do. A diverse and thriving civil society *is* an end in itself, in fact it is many. One end is to function as a counter-weight to state power and the fabric which supports society as a whole.

If eligibility is not limited based on legal form, what other criteria would the Bank use to ensure it supported only projects which really are about positive social and environmental change? Would the SIWB facilitate funding for an oil company's corporate social responsibility activities, for example? How would it make a judgement about whether this was in fact simply 'greenwashing'? How would it prevent private companies, which could access capital from mainstream markets, from taking advantage of this pot of 'social' finance, simply because it might present more appealing terms?

10. This consultation suggests that the mission of the Bank could be to create social and environmental value through increasing investment for a social or environmental purpose. How do you think the mission of the Bank should be defined?

That mission is probably as good as any, but we don't know what social and environmental 'value' is, as this probably refers to some kind of dubious quantitative formulae. Social or environmental 'value' in this context is a measurement of something (the outputs of work that is being supported with finance) not something in itself. The Bank should exist to facilitate *work* that has social and environmental value, not the measuring of that work.

11. Do you agree that the SIWB would need to be flexible and adaptable to address evolving issues as the market develops? How could it be ensured that the Bank would respond appropriately to the evolving market?

Yes it should be flexible and adaptable, and it should respond to the evolving market, but that is not our main concern. We think the potential for it to interfere, malfunction, and even damage the existing market simply by its very existence is of far greater concern.

12. How best could the Bank be structured and owned in order to deliver its functions and meet its mission?

The Bank should be independent of government but accountable in some way to the end customers. As a wholesale provider this makes the issue of accountability more complicated. The possibility of it being run on some kind of co-operative basis should be explored.

The Bank should be governed by a board of unpaid, voluntary trustees, rather than paid company directors who have a financial interest in its performance. Trustees should be selected according to the required skills and should not have any vested interest in the creation or promotion of the Bank, the increase in provision of social investment, or policy advocating the creation of the Bank. Otherwise, the whole enterprise will be an exercise in certain movers and shakers being able to argue themselves into lucrative and influential positions.

13. Under what circumstances could an SIWB carry out activities itself, rather than being limited to financing and offering support to others?

We cannot offer a view at this time.

14. Do you agree that the Bank should seek to report transparently against a 'triple bottom line' of social, environmental and financial value? What ideas do you have for how this could be achieved?

All of the Bank's activities need to be transparent – that includes its governance, its financial management, and information about the investments it makes. Clearly this is a fundamental lesson from recent events with the mainstream banks – in fact if the SIWB is created it should be an exemplar of transparency.

The triple bottom line could be a way to report its impact but we have doubts about whether the measures of social or environmental value will really mean anything.

15. Do you agree that the Bank would not distort competition to an extent contrary to the common interest if it followed the guidelines set out in this consultation? What mechanisms or safeguards could be put in place to ensure this, while still enabling the Bank to effectively carry out its mission and functions?

Our view is that there is a real risk that the Bank could distort competition simply by its existence. Much will depend on whether the Government decides to build a new institution from scratch, which would be costly, or if it conducts a tendering exercise to deliver the Bank – as would seem to be the preferred method in many other situations. If the latter course is taken, there will be a limited number of organisations that are able to take on its function. The likely candidates would be the existing players in the market, and there would be a significant risk that awarding the contract to one of them would distort competition.

On page 26 the consultation seems to suggest that the risk of any distortion of competition in the context of EU rules on State Aid could be minimised by restricting the investments to charities, Community Interest Companies, or small local enterprises working in social policy areas. This seems to jar with the language on page 23, which suggests that the Government is attracted by the idea of the Bank's work being 'defined by social and environmental outcomes and not by eligibility on the basis of form'. We doubt that a simple and practical means could be devised that will ensure that investment supports the required outcomes without using organisational form as a selection criterion.

16. How would you make a robust assessment of the necessary financial requirements over time of an SIWB, and what evidence is there to back this up?

We are unable to supply evidence, but surely simple common sense would suggest the Government needs to think through the following questions carefully in any periodic assessment:

- How much capital does the Bank have? Has it increased / decreased?
- What has been the level of demand on the Bank's capital from providers of social investment? How has the Bank responded to that demand?
- What return is the Bank getting on its investments? Has this added to the Bank's capital or has it been distributed in further investments?
- What is the level of default on investments facilitated by the Bank?
- Does the Bank need to adjust its attitude to risk vs. return based on the above questions? How?

17. The Government recognises uncertainties around the capacity and willingness of the third sector's demand for finance. How could the risk of this undermining the success of the Bank be mitigated?

This is turning the issue completely on its head. It is like saying: 'we are going to close 100 hospitals. How can we mitigate the risk of voters undermining our plans?' If the Government acknowledges that this is a risk, the Government needs to get to the bottom of understanding *why* before proceeding any further! Otherwise the real risk is that millions of pounds of public money will be squandered, for a policy and an institution that doesn't deliver what is really needed.

18. Do you agree with the principles for the design of an SIWB outlined in this consultation?

As we said at the beginning of this piece, and for the reasons subsequently stated, on the whole DSC is not convinced that there is strong evidence of need for a Social Investment Wholesale Bank.

However, we have also tried to provide a constructive view on the Bank's design and function where possible, since it may become a reality. It is vital that any future Bank be relevant to the voluntary sector as a whole, a model of transparency and accountability, have a governance structure that does not reward the personal financial self-interest of directors, and is effective in using its investment (of public money?) to support positive social and environmental outcomes.