

The Financing of Social Enterprises: A special report by the Bank of England

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A Summary of the Report

The Bank of England's (BOE) report, published in May 2003, is the first time that the BOE has really considered '*social enterprises*' as a distinct form of small or medium sized business enterprise (SME). It is also the first time that it has considered giving access to these businesses, to the various sources of finance. ***This is an importance step in social enterprise development.***

The report considers the demand and supply of external finance for social enterprises in the UK, and includes a survey of 200 social enterprises (SEs) and a matched sample of 123 for-private-profit small and medium sized enterprises (SMEs), on their use of loan and equity finance. The definition of a social enterprise (SEs) conforms to that used by the UK Department of Trade and Industry (DTI), and is seen as:

“A social enterprise is a business with primarily social objectives whose surpluses are principally reinvested for that purpose in the business or in the community, rather than being driven by the need to maximise profit for shareholders and owners.”

In particular, the survey showed that access to finance, in one form or another, was the main barrier to growth. Grant finance was the main form of external finance for SEs, rather than debt or equity finance. However, the data showed that 48% of SEs surveyed had sought external finance, a lower ratio than the 59% of SMEs that had sought such finance. Demand for external finance was more prevalent in well-established SEs with a large employee base.

The reasons given for reluctance to seek external finance include lack of need (for both SEs and SMEs), a preference for grant finance (35% of SEs), risk aversion by board members (25% of SEs) and lack of income. Twenty-three percent of those surveyed showed a reluctance to take-up commercial finance for a number of reasons, including aversion to the risks of borrowing, lack of information and knowledge of financial and banking business.

Report Recommendations

Demand factors

The report notes that the demand for debt finance is limited both by availability of other, cheaper forms of funding, such as grants from charitable foundations and government, and by risk aversion. The recommendations include:

- highlighting examples of successful borrowing;
- better advice by the government-funded business support agencies, tailored to needs of social enterprises;
- better information and guidance to make social enterprise more investment-ready; and
- to improve the knowledge and awareness among lenders of social enterprises.

The facilitation of supply

There is evidence of a higher rejection rate among SEs applying for debt finance, than SMEs. This leads to a perception among social enterprises that finance is a barrier to expansion. To counter this, the report recommends:

- increased finance, available to CDFIs (Community Development Finance Institutions) that specialise in lending to social enterprises;
- raising awareness of successful joint lending by CDFIs and banks;
- increasing awareness of social enterprises in banks, by ensuring that central lending policies designed to support social enterprises, are acted on by local managers; and
- by better distinguishing social enterprises from SMEs.

Other recommendations include:

- the development of a brokerage service by the DTI (Department for Trade and Industry) using local financial experts to arrange finance packages for social enterprises; and
- for grant providers (including government) to review and amend administration processes to make it easier for SEs to leverage other forms of finance.

'Patient' capital

This is start-up or expansion funding, comprising investment grants structured as debt or equity, where the lender accepts lower or uncertain financial returns in exchange for social outputs. Proposals here include:

- tax relief to encourage private investors;
- the possible development of a 'social angels' network to match social investors with social enterprises;
- a proposal for government to review current pilot initiatives to develop innovative approaches to funding social enterprises;
- similar encouragement for charitable trusts and foundations to be more innovative;
- examination of regulatory exemptions relating to shares that take account of the special characteristics of social enterprises; and
- the development of social auditing tools to benchmark the performance of social enterprises.

Further Information

The report – *The Financing of Social Enterprises: A Special Report by the Bank of England* - is available, free of charge, from <http://www.bankofengland.co.uk/financialstability/businesshouseholdfinance/smallfirms> or by ringing the Bank's Public Enquiries Group on 020 7601 4878

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