Growth Fund Evaluation

Update Report 1: Programme learning

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Foreword

This report is the first in a series that will be developed by the evaluation over the lifetime of the Growth Fund. There is much yet to learn and The National Lottery Community Fund has invested in this longitudinal study out of a recognition that the Growth Fund is breaking important new ground.

This report shows that this can be a more nuanced process than we all may have envisaged in the enthusiastic heat of designing a pathfinding collaborative programme. But a head of steam is now beginning to build and it is a significant success that by the time of publication, 14 delivery partners had been appointed as the Fund’s social investors and are now providing unsecured lending.

Several of these are new to operating as lenders but bring deep insight into the Voluntary, Community and Social Enterprise sector that come from their relationships with it as grant makers, umbrella bodies, sectoral pathfinders and specialists in their field.

Some are also established social investors, whose experience has been much appreciated by newer peers and the Programme Partners in the reflective discussions that Access bring us all together around, in order to learn about this ground we are all breaking together to increase reach to VCSEs who need more accessible finance to build their impact.

The programme’s Theory of Change continues to be a live document to support our path-finding learning. It is continuously being informed by what we learn from the ‘praxis’ of change – the real experience of all the programme’s stakeholders as it unfolds. We are setting out to test assumptions, and discovering important lessons for the future.

In particular, we are learning about the importance of the functional-design and quality of relationships at all levels of the programme’s architecture – from what’s helpful at the programme management level to the investee/investor level. And we are also identifying important lessons about how the programme’s relationships with other social business support initiatives and wider sector dynamics will bear on its success.

The provision of accessible social investment is an important ingredient for VCSEs who need a loan to bring in the new revenue through enterprising activity that will build their way to greater impact and resilience. But it is part of a recipe involving other ingredients which together make a unique ‘bake’ for each VCSE, according to their goals, operating context and access to support. Together with Access and its wider work, Big Society Capital and the programme stakeholders, this evaluation will help ensure that lessons from investees’ experience of the Growth Fund makes unsecured lending the most helpful ingredient it can be for VCSEs into the future.

James Harcourt, Director of England Grant-making, National Lottery Community Fund

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Executive Summary

In 2015 The National Lottery Community Fund[1], Big Society Capital (BSC) and Access (all three organisations collectively known as the Programme Partnership) launched the Growth Fund, with the aim of addressing specific gaps in the social investment market in England. In 2016, the Programme Partnership commissioned Ecorys and ATQ Consultants to evaluate the programme. This report is part of the first set of Update Reports, and reports on the set-up of the Growth Fund programme. The other report in this first set of Update Reports focuses on delivery so far.

The Growth Fund and the evaluation

The Growth Fund

The Growth Fund was launched in 2015 with the aim of addressing specific gaps in the social investment market in England. In particular, the Growth Fund was established to increase the availability of relatively small amounts (<£150k) of unsecured[2] or small but higher risk finance for voluntary, community and social enterprise sector organisations (VCSEs). The Growth Fund has a unique structure of blended finance, which combines grant[3] funding and loan[4] funding in a total pot worth at least £45 million. The Growth Fund makes investments of both loans and grants into funds run by social investors who then provide loans and grants to VCSEs. The social investors can use the grant supplied by the Growth Fund to support their operations in three ways:

- **Grant A:** Social investors use this grant to cover some of the operating costs that arise from running the fund before the investor has sufficient revenue from VCSE loan fees and interest[5] to meet its costs
- **Grant B:** Social investors use this grant as 'first loss capital'[6] to cover expected defaults from the VCSEs and reduce the risk of return and capital[7] loss of the debt providers
- **Grant C:** Social investors can choose to pass this grant onto their VCSE clients alongside a loan.

The management of the Growth Fund is led by Access, with operational support from BSC and The National Lottery Community Fund. The Growth Fund is governed by a Joint Investment Committee (JIC), which is comprised of stakeholders from BSC, The National Lottery Community Fund and Access.

At the time of writing (November 2018) 14 funds were live, with two agreed but not yet live.

[1] Formerly the Big Lottery Fund.
[2] Unsecured loan: a loan that does not take security over an organisation's assets. Because the risk for the lender is greater, interest rates are usually higher than for secured loans. The Good Finance glossary has been used to provide definitions in this report.
[3] Grant: a conditional or unconditional gift of money with no expectation of repayment.
[4] Loan: a sum of money which is borrowed and has to be paid back, usually with interest.
[5] Interest: fee paid by a borrower (in this case VCSE) to a lender (in this case social investor) to pay for the use of borrowed money. When money is borrowed, interest is typically paid to the lender as a percentage of the amount owed. Interest usually accrues on a daily basis but is charged less frequently, e.g. monthly, quarterly or annually.
[6] First loss**:** it is possible to have different tiers of investors so that one set of investors accepts that, in the event that the investee suffers financial difficulties, it will lose the money it invested before any of the other investors lose any money. This investor will bear the 'first loss'. In this specific instance, this grant is used to cover the first set of losses, before the social investor has to bear the cost itself of losses.
[7] Capital: capital usually refers to financial capital or money and in particular the amount of cash and other assets held by an organisation.

The Growth Fund evaluation

The National Lottery Community Fund commissioned Ecorys UK, in partnership with ATQ Consultants, to undertake the evaluation of the Growth Fund. The evaluation runs until 2022 and aims to assess and track the effectiveness of the Growth Fund in enabling a wider group of VCSEs to successfully access social investment, become more resilient and deliver greater social impact[8]. It aims to capture evidence on process and impact, by investigating four key areas:

- The most effective approaches to the use of subsidy in building the market of small-scale unsecured or higher risk loans and the provision of grants and loans to VCSEs
- The impact of the Growth Fund on how social investors provide social investment to VCSEs – with and after subsidy – and how other funders and lenders outside of Growth Fund have been influenced
- The impact of the Growth Fund on the understanding and take-up of social investment amongst VCSEs
- The extent to which greater take-up of social investment leads to greater financial resilience and social impact.

There are two key strands of research activities:

- VCSE research, comprising:
    - 20 longitudinal case studies with a selection of the VCSEs supported
    - Analysis of Management Information (MI) data including data from the investors' quarterly reports and annual social impact returns
    - Survey of all VCSEs
    - Consultations with 10 unsuccessful VCSE applicants

- Social investor and programme management research, comprising:
    - Annual one-to-one consultations with social investors
    - Consultations with unsuccessful social investors
    - Annual consultations with members of the Programme Partnership.

This report draws on the following research:

- Semi-structured interviews with 11 social investors
- Case studies at the baseline stage with three VCSEs
- Semi-structured interviews with the Programme Partnership
- Analysis of quarterly data returns containing information on 277 VCSE applications.

This report covers qualitative evidence on the experiences of setting up the Growth Fund, including social investors' experiences of applying to the Fund. Learning on the most effective approach to providing small-scale loans and grants to VCSEs is explored in a separate report, which focuses on delivery so far.

[8] Social impact: There is no one definition of the term or concept, but the social impact can be defined as the effect on people that happens as a result of an action or inaction, activity, project, programme or policy. The 'impact' can be positive or negative and can be intended or unintended, or a combination of all of these.

Setting up and running the Growth Fund: Progress and lessons learnt at the programme level

Programme Partnership

The Growth Fund is an innovative and novel partnership working to make social investment available to VCSEs who have not been able to access it before; it is therefore not surprising there have been challenges in implementation.

Implementation challenges were compounded by two factors:

- **Complex nature of the Programme Partnership** (i.e. the requirements of three diverse partners to collaborate whilst addressing their respective accountabilities): Future similar programmes would benefit from channelling the grant and loan to the social investors through one organisation.
- **Lack of clarity on the roles and responsibilities in the decision-making process during both the set up and delivery of Growth Fund**: Decisions in relation to the Growth Fund were made at the JIC meetings or dealt with on an ad hoc basis by the respective partners. However, the Programme Partnership found this was not sufficient to discuss operational issues in a structured and shared manner. Consequently, the JIC established a Growth Fund Management Group in the hope that this would resolve this challenge. We would encourage the partnership to focus on the Growth Fund Management Group as the vehicle for delivery decision-making.

Range and structure of investment funds

The programme had achieved its aim of encouraging a wider group of organisations to become social investors and offer loans and grants below £150k. Many stakeholders interviewed were excited by this development.

The social investment funds were structured so they would largely be able to cover their costs through income from interest and fees after 12 to 18 months, with Grant A supporting early operating costs. Deployment challenges meant some social investors struggled to achieve this, affecting their financial stability. The way the funds were structured was therefore seen by one key stakeholder as a "*profound mistake*". Programmes deploying grant and loan funds to newly-established social investors should be structured with more flexibility, so that their financial sustainability is not so closely tied to early deployment of funds.

There was some disappointment in the (limited) degree of loan-product innovation across the programme. Increasingly stakeholders within the social investment sector have argued that social investors need to offer a broader range of investment products to meet VCSE demand, such as providing more patient capital[9].[10] Whilst there are some innovative products on the margins of the Growth Fund, typically most Growth Fund social investors are offering VCSEs an unsecured, fixed-term loan with an interest rate of between 6 and 12%. Several Growth Fund social investors argued that the Growth Fund was not designed in a way that would foster loan-making innovation, due to:

- it not being clear in the application process that the Programme Partnership was interested in product innovation; and
- the 5% interest they themselves had to pay back on the loan from Big Society Capital, which hindered their ability to offer more innovative products.

Portfolio management

The resources required for managing the portfolio of social investment funds had been under-estimated.

Some social investors felt Access could play a greater role in supporting cross-fund joint activity between social investors, such as running joint marketing activities.

Working with social investors in the programme

The Growth Fund explicitly sought to diversify the number of social investors providing repayable loan finance and succeeded in attracting a diverse range of applicants.

The application, approval and post-approval process proved to be lengthy and challenging for all applicant social investors, mainly due to the complex legal arrangements between the social investors, Access, Big Society Capital and The National Lottery Community Fund.

However, one advantage of the length of time taken and the rigour of the due diligence process, especially for new social investors, was improved plans.

There are some relatively simple actions at the programme level for any future small-scale and higher-risk or unsecured-loan market-building programmes to take:

- Greater use of templates (such as contract and loan templates) to prevent duplication and help keep negotiations simple
- Design of a value-adding due diligence process that reflects fully organisations' respective starting points
- Setting clear expectations over legal agreement requirements to ensure no surprises that can otherwise affect trust in the long-term relationship between the programme partnership and social investor.

[9] Patient capital: loans or equity investments offered on a long-term basis (typically five years or longer). It is often used to describe long-term investment by investors looking for non-financial as well as financial gains and may be offered on soft terms (e.g. capital/interest repayment holidays and at zero or sub-market interest rates).
[10] Wooldridge et al (currently unpublished). Social Investment Rapid Evidence Assessment for Big Society Capital.

Conclusions, lessons learnt and recommendations

As one stakeholder commented, Growth Fund is "*doing what it said on the tin".* The findings reported in the first set of Update Reports suggests that it has encouraged new lending activity in an area of the social investment market where demand was not met. The three case-study VCSEs looked at so far have had a positive experience. Many stakeholders are excited about what the Growth Fund will achieve. This is a very positive achievement.

This 'headline' achievement, however, masks many challenges. The Growth Fund is a complex and innovative programme and at times it has been difficult to implement. The social investors that are new to social investment have struggled with deploying loans, and their activity is below original projections. A lot of lessons have been learnt along the way, and these have been captured in this report and summarised in Table 1 below. What is unclear at the moment is whether these challenges are fundamental issues and miscalculations around the on-going level of demand for social investment and the speed with which it can be converted into viable deals, or whether they are early-stage teething issues that can be resolved with commitment and hard work.

Notwithstanding these difficulties, all of the established and newer social investors are themselves 'sold' on the concept of building the market through both blending grant with loans for investors' operations, and grant with loan for VCSEs. They are keen to make it work both for their clients and the social impact that they deliver, as well as for themselves

The next 18 months, as these challenges are worked through, will be a major test for the Growth Fund.

These challenges, and the things that were designed into the programme which have worked well, have generated points to note, as detailed below:

Table 1: Lessons learnt for organisations running repayable finance market-building and capital deployment programmes

1. Spend more time upfront in planning through the finer details of the fund structures and processes for operational decision making.
2. It is important to make a decision early about whether a social investor's fund application should progress.
3. There need to be clearer decision-making processes between the organisations who lead a blended-finance market-building programme, to translate their high-level decisions into operational execution.
4. It is simpler for the programme partnership and social investors if the grant and loan for the social investors is deployed through the same organisation.
5. Programmes deploying funds to newly-established social investors should be structured with more flexibility, so that their financial sustainability is not so closely tied to early deployment of funds. Slower-than-anticipated deployment should be carefully managed to reduce the financial risk it places on social investment funds.
6. If the programme partnership wants to achieve loan product innovation then this innovation needs to be built into the design of the programme and the structuring of the wholesale capital offer.
7. Running a market-building fund of this ground-breaking nature takes more resources than may be initially anticipated due to challenges faced during delivery.
8. Distribution of templates (e.g. contract and loan templates) and agreed wordings in advance will save time, particularly if they can be cognisant of the different organisation structures e.g. membership bodies.

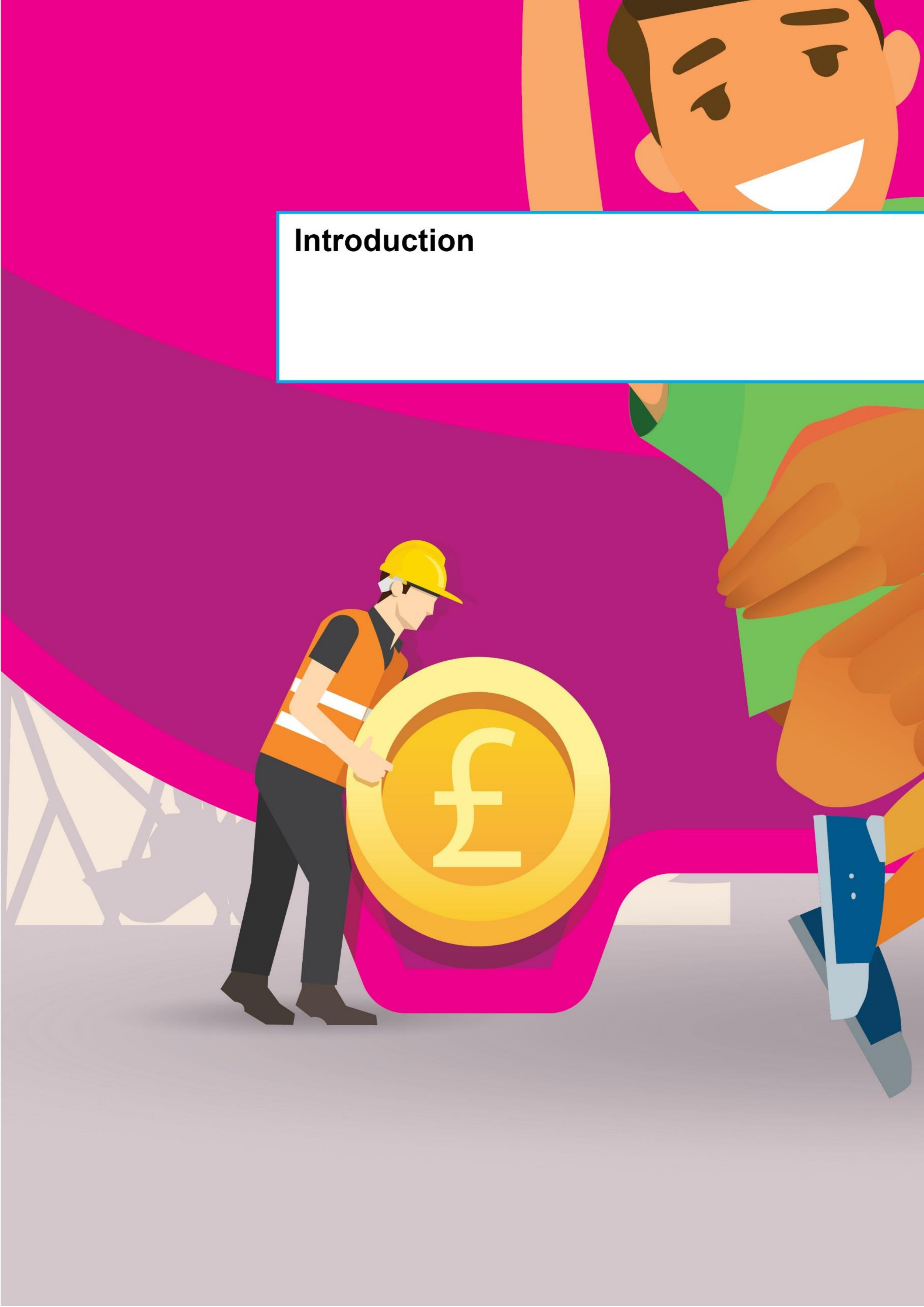
9. There are considerable benefits to the due diligence process, especially for new social investors. As far as practicable, due diligence needs to be adaptive to the social investor organisations - taking into account their starting point and experience, so as to add the most value into the process.
10. The legal aspects of the process need to be clearly understood at programme level and then explained to investors to set expectations about the extent of work required to finalise agreements.

Recommendations

- Re-examine the structure and assumptions of the new Growth Fund funds in the early stages and about to be deployed, to ensure lessons from the first funds have been learnt and applied to later funds
- Prioritise establishing the new ways of working of the Growth Fund Management Group
- Access to consider playing a market engagement convener role where numerous social investors are operating in the same space

Undertake detailed debriefing with social investors to understand and resolve gaps in social impact data. Spend more time with social investors and VCSEs well in advance of the next social impact data return to co-design a strategy to ensure there are fewer gaps in data.

Introduction



1.1 The Growth Fund

In 2015 The National Lottery Community Fund[11], Big Society Capital and Access (collectively known as the Programme Partnership) launched the Growth Fund, with the aim of addressing specific gaps in the social investment market in England. In 2016, the Programme Partnership commissioned Ecorys and ATQ Consultants to evaluate the programme. This Update Report 1 is the first evaluation report, and reports on the set-up and early stages of the programme.

This chapter provides more information on the Growth Fund, the evaluation, and the focus of this report.

1.1.1 Background and aims of the Growth Fund

The Growth Fund was launched in 2015, with the aim of addressing specific gaps in the social investment market in England. In particular, the Growth Fund was established to increase the availability of relatively small amounts (<£150k) of finance for voluntary, community and social enterprise sector organisations (VCSEs). It was aimed at VCSES in their early stages of growth or to those looking to sustain their activity, as well as to organisations whose risk profile or trading history would normally exclude them from both the social investment as well as commercial loan market.

The Growth Fund is facilitated by an innovative partnership between The National Lottery Community Fund, Big Society Capital and Access. These organisations are summarised below:

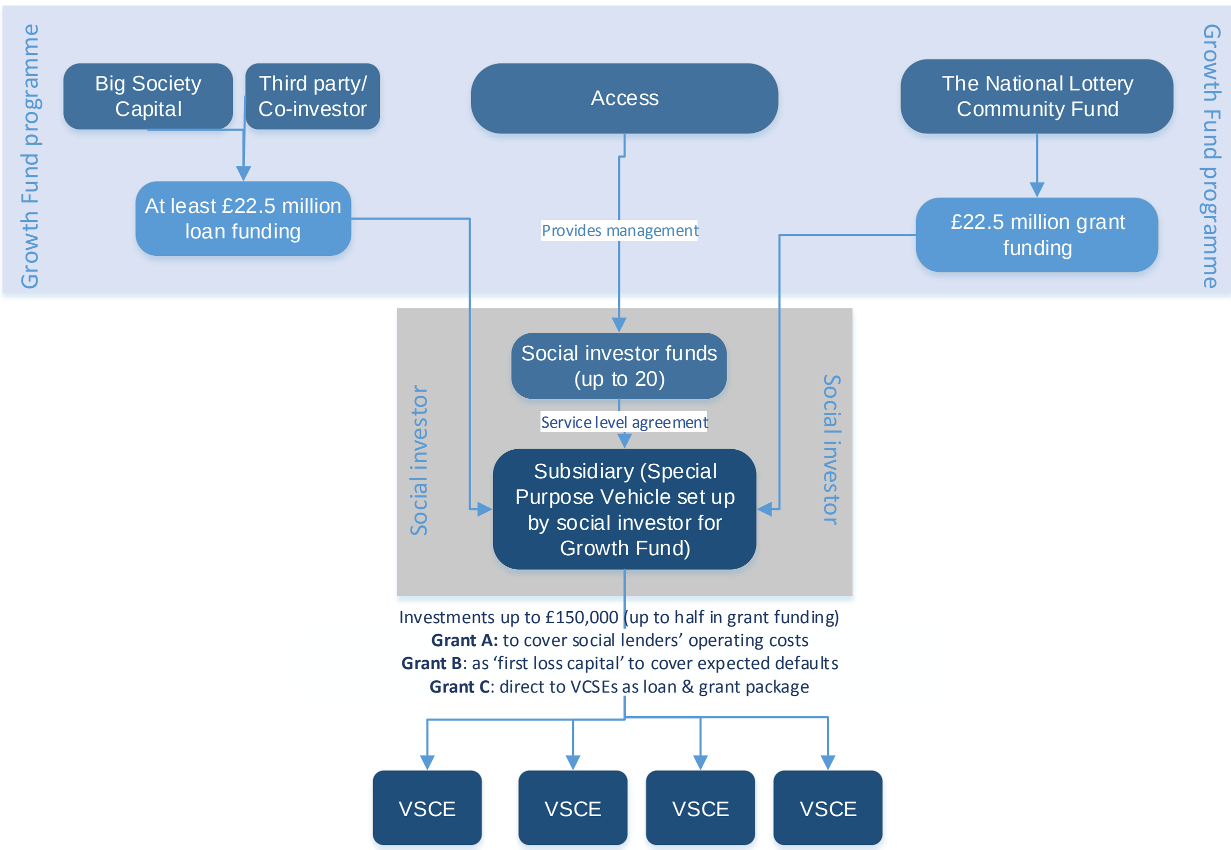
- The National Lottery Community Fund is a non-departmental public body that operates across the UK. The organisation's mission is 'helping communities and people most in need', and its vision is that people should be in the lead in improving their lives.
- Big Society Capital has played a leading role in the development of the social investment market in the UK. It aims to improve lives in the UK by connecting social investment to charities and social enterprises. It does this by engaging with investors, fund managers, charities and social enterprises to make it easier to use social investment, and by making investments into intermediaries, who in turn invest in charities and social enterprises.
- Access was established to help charities and social enterprises in England to be more financially resilient and self-reliant, so that they can sustain or increase their impact. It does this by supporting the development of enterprise activity so VCSEs can grow and diversify their income and by improving access to the social investment, which can help stimulate that enterprise activity.

[11] Formerly The Big Lottery Fund.

1.1.2 The structure of the Growth Fund

To enable finance to be available in a form that is affordable for both those providing and receiving it, the Growth Fund has a unique structure of blended finance, which combines grant funding and loan funding in a total pot worth at least £45 million. **Figure 1.1** provides an overview of the structure of the Growth Fund. The National Lottery Community Fund provides grant funding of £22.5 million, and Big Society Capital provides loan funding of at least £22.5 million. Third party investors (or co-investors[12]) are encouraged to invest alongside the grant, and in some cases this may be in lieu of Big Society Capital investment, and in other cases, it may be alongside it. The management of the Growth Fund is led by Access, with operational support from BSC and The National Lottery Community Fund. Investments of both loans and grants are made into funds run by social investors, who then make loans and blended loan/grant packages into VCSEs. The social investors have to repay the loan to BSC, including with 5% interest. The rationale for this interest rate was to demonstrate sustainability and attractiveness for other investors of loan funds providing small scale finance to VCSEs.

Figure 1.1: Structure of the Growth Fund



[12] Co-investment: investment in a project or fund alongside and often on the same terms as other investors.

To ensure that the Growth Fund had a diverse portfolio, social investors were selected partly on the basis of whether their offer aligned with at least one of the following three market development themes:

- **Efficiency** If the funds meet current demand from VCSEs for smaller, unsecured loans/grants in an efficient way.
- **New Approaches** If the funds offer creative and relevant new products or new ways of delivering social investment to the sector.
- **Reach** If the funds offer social investment and make it relevant for VCSEs who have not benefitted previously.[13]

Reflecting the fact that the Funds have varied activities and remits, some social investors have been classified by more than one of these themes. For example, a fund may be classified as offering both 'New Approach' and 'Reach' because it is offering a new type of product, to a group of charities or VCSEs that have not been able to benefit from social investment in the past.

At the time of writing (November 2018) 14 funds were live with two agreed but not yet live. **Table 1.1** provides details on the funds, including their name, total loan and grant amount (including split between Grants A, B and C, see Growth Fund grant uses) and details of any co-investors.

[13] Access: The Foundation for Social Investment. 2016. The Growth Fund – An Introduction. Available from: https://access-socialinvestment.org.uk/wp-content/uploads/2016/07/Growth-Fund-guidance-basics-v3.pdf

Table 1.1: Live social investor funds

Name of social investor and fund	Name of fund	Remit	Fund Established Date	Approved Total Fund Size	Grant A: Operating cost subsidy	Grant B: Grant for Loans to VCSE	Grant C: Grant passed on as grant	Approved Access total	Approved: Loan component from BSC	Approved: Co-Investment
Key Fund	Northern Impact Fund	North of England and Midlands regions with a thematic focus on newer ventures or business activities and first time users of social investment financing	19/09/2016	£5,359,489	£200,000	£1,358,589	£1,104,000	£2,662,589	£2,696,900	
Big Issue Invest (BII)	Impact Loans England	England wide remit and no thematic focus	20/12/2016	£5,067,438	£140,000	£1,300,844		£1,440,844	£3,626,594	
BII	Impact Loans England (II)	England wide remit and no thematic focus	02/11/2018	£3,925,787	£125,000	£1,268,339	£228,000	£1,621,339	£2,304,448	
Homeless Link	Homeless Link Social Investment Fund	National remit with thematic focus on addressing issues of homelessness	19/05/2017	£4,483,338	£200,000	£1,075,000	£962,500	£2,237,500	£2,245,838	
First Ark	Invest for Impact	North West region with no thematic focus.	11/10/2016	£4,006,487	£170,000	£689,122	£1,080,000	£1,939,122	£2,067,365	
NESTA	Cultural Impact Development Fund	National remit with thematic focus on providing finance to socially-driven arts and cultural organisations	16/10/2018	£3,708,467	£120,000	£1,130,367		£1,250,367	£2,458,100	
Resonance	Health and Wellbeing Challenge Fund (South West)	South West region and thematic focus on health and wellbeing	19/07/2016	£3,414,355	£125,000	£775,504	£805,000	£1,705,504	£1,489,720	£219,131 (South West Academic Health Science Network)
Environmental Finance	PICNIC	National remit with a thematic focus on public parks, expected to particularly target three city regions	30/10/2018	£3,248,503	£119,500	£826,069	£300,000	£1,245,569	£2,002,934	
UnLtd	UnLtd Impact Fund	National remit with thematic focus on addressing barriers to employment and training	20/10/2017	£3,190,734	£133,000	£791,320	£420,000	£1,344,320	£1,846,414	
Sporting Assets	Sporting Capital Fund	National remit with thematic focus on sports organisations delivering social outcomes for communities	27/06/2017	£3,081,192	£105,000	£1,026,786		£1,131,786	£1,949,406	

Name of social investor and fund	Name of fund	Remit	Fund Established Date	Approved Total Fund Size	Grant A: Operating cost subsidy	Grant B: Grant for Loans to VCSE	Grant C: Grant passed on as grant	Approved Access total	Approved: Loan component from BSC	Approved: Co-Investment
Orbit Group and partners	Community Impact Partnership	National remit but targeted mainly on the areas covered by the partners (East Midlands, East, London, South East)	12/11/2018	£2,984,226	£120,000	£621,849	£472,500	£1,214,349	£1,769,877	
The SIB Group and Forward Trust	Forward Enterprise Fund	National remit with thematic focus on addressing issues of addiction recovery and/or people who are ex-offenders	23/04/2018	£2,053,302	£87,852	£542,544	£270,000	£900,396	£1,152,906	
Greater Manchester Centre for Voluntary Organisation (GMCVO)	GM Social Investment	Greater Manchester geographical area only and no thematic focus	10/07/2017	£2,035,237	£100,000	£492,452	£420,000	£1,012,452	£1,022,785	
Devon Community Foundation	Devon Social Investment Fund	Geographical focus on Devon, Plymouth and Torbay and all services except for health and wellbeing	21/07/2017	£1,229,991	£55,800	£280,299	£270,000	£606,099	£323,892	£300,000 (Devon Community Foundation)
Kent Community Foundation	Kent Social Enterprise Loan Fund	Geographical focus on Kent and Medway, focusing on new and existing social enterprises	25/10/2017	£1,124,172	£50,000	£205,543	£252,000	£507,543	£0.00	£616,629
Somerset Community Foundation	Somerset Social Enterprise Fund	Somerset geographical area only with no thematic limit	17/08/2017	£1,095,784	£49,000	£67,178	£375,000	£491,178	£0.00	£604,606 (Somerset County Council)
Total Sum				**£50,008,502**	**£1,900,152**	**£12,451,805**	**£6,959,000**	**£21,310,957**	**£26,957,179**	**£1,740,366**

1.1.3 Growth Fund grant uses

Reflecting the various different needs of the social investors and the VCSEs, the three types of grant component could be used for the following purposes:

- **Grant A:** Social investors use this grant to cover some of the operating costs that arise from running the fund before the Investor has sufficient revenue from VCSE loan fees and interest to meet its costs. It is anticipated at a portfolio level that this will not be larger than 10% of the total grant (i.e. A, B and C combined).
- **Grant B:** Social investors use this grant as 'first loss capital' to cover expected defaults from the VCSEs and reduce the risk of return and capital loss of the debt providers.
- **Grant C:** Social investors can choose to pass this grant onto their VCSE clients alongside a loan.

1.1.4 The Reach Fund

During the process of applying for investment from the Growth Fund, VCSEs have the opportunity to access investment readiness support through the Reach Fund. Prior to the establishment of the Growth Fund, evidence had suggested that there was demand for small scale unsecured finance, but it became clear that there was a need for investment readiness support once demand converted from a latent interest to active pursuit of a loan. Established in 2016 by Access, the Reach Fund provides support to VCSEs who are already close to the point of taking on social investment. VCSEs can register for the Reach Fund and complete a diagnostic tool that asks about Governance and Leadership, Impact and Vision, Market Potential, Financial Performance and Operations. Upon completion of the tool, VCSEs are able to see a report that details the areas in which they could benefit from additional support. They then share the report with an 'Access Point' (that is, a social investor[14]) who decides whether or not to invite them to apply for Reach Fund support. If Access Points do feel the support is necessary, VCSEs can then progress to apply for Reach grant funding of up to £15,000 to pay for the specific support that they need.[15]

1.1.5 Governance

The Growth Fund is governed by a Joint Investment Committee (JIC), which is comprised of stakeholders from Big Society Capital, The National Lottery Community Fund and Access. The JIC has oversight over applications to the Growth Fund, and are the final decision makers on the approval and allocation of grant and investment. As the Growth Fund is now in its delivery phase, the main role of the JIC is to oversee investment performance and approve remedial plans if funds are underperforming. The JIC will also approve the allocation of additional funds to existing funds.

In 2018 the Programme Partnership established a Growth Fund Management Group (GFMG), and the JIC delegated operational matters regarding investments in the Growth Fund portfolio to the GFMG.

[14] Not all of the Growth Fund social investors are 'Access Points'.

[15] For more information see: www.reachfund.org.uk

The Growth Fund includes a series of legal agreements between organisations:

- An External Delegation Agreement (EDA) for The National Lottery Community Fund to delegate their grant making authority to the social investor
- A Loan agreement with Big Society Capital (and any co-funder)
- A Share Charge that allows the lender(s) to take security over the subsidiary company which will manage the fund
- The Service Level Agreement (SLA) between the subsidiary and the social investor
- A Deed of Priority may also be required if there is a co-funder or if other lenders have taken security over the social investor

1.2 The evaluation

The National Lottery Community Fund commissioned Ecorys UK, in partnership with ATQ Consultants, to undertake the evaluation of the Growth Fund. The evaluation runs until 2022, and aims to assess and track the effectiveness of the Growth Fund in enabling a wider group of charities and social enterprises to successfully access social investment, become more resilient and deliver greater social impact. It aims to capture evidence on process and impact, by investigating four key areas:

- The most effective approaches to the use of subsidy in building the market of small-scale unsecured or higher risk loans and the provision of loans and grants to VCSEs
- The impact of the Growth Fund on how social investors provide social investment to VCSEs – with and after subsidy – and how other funders and lenders outside of Growth Fund have been influenced
- The impact of the Growth Fund on the understanding and take-up of social investment amongst VCSEs
- The extent to which greater take-up of social investment leads to greater financial resilience and social impact.

The reporting (including this report and the other report on 'Experiences of Social Investors and VCSEs') does not address all four of these areas in detail because the timescales of the programme and the evaluation means that there is not sufficient evidence to do so. Therefore, the reports cover early qualitative evidence on the most effective approach to providing small-scale loans and grants to VCSEs, from the perspectives of social investors and VCSEs, as well as some learning on how applying to the Growth Fund has impacted social investors so far. There is some qualitative evidence to describe the impact of the Growth Fund on the understanding and take-up of social investment amongst VCSEs, but this will be explored in more detail as the evaluation progresses. Similarly, it is generally too soon to comment on the extent to which a greater take-up of social investment leads to greater financial resilience and social impact, but this report discusses some early findings on financial resilience and social impact.

1.2.1 Methodology

Ecorys and ATQ are conducting a process and impact evaluation, using a mixed-methods approach to meet the aims of the evaluation. There are two key strands to the research activities, as described below:

1.2.1.1 *VCSE research*

The VCSE research aims to capture VCSEs' experiences of the Growth Fund, as well as measure the financial and social impact of the loans and grants that they receive. Several VCSE research activities are being undertaken throughout the course of the evaluation, as follows:

- **20 longitudinal case studies with VCSEs** to capture their experiences of applying for investment, their experiences of using the social investment, and the short-, medium- and longer-term social and financial impacts of the loans. Visits are being undertaken at the baseline, at the mid-point of the loan term, and at the end of the loan term.
- **Analysis of Management Information (MI) data** including data from the investors' quarterly reports and annual social impact returns. These provide information on loan and grant activity, indicators of VCSEs' financial resilience, data on the type and number of beneficiaries reached by the VCSEs and progress by each VCSE against at least one of their chosen social outcome indicators.
- **Survey of all VCSEs** to measure: experiences of taking on and repaying social investment, and the extent to which changes in financial resilience and social impact can be attributed to the social investment. VCSEs complete the survey at baseline (within three months of taking on the social investment) and then on an annual basis.
- **Consultations with 10 unsuccessful applicants** to understand their experiences of the application process and whether they have accessed social investment since.

1.2.1.2 *Investor and programme management research*

The investor research aims to gain reflections on the progress of the Growth Fund at the programme level and the individual Fund level. This research is qualitative in its nature, and involves the following activities:

- **Annual 1:1 consultations with social investors** to gain their reflections on applying for, setting up, and delivering the Funds.
- **Consultations with unsuccessful social investors** to build up a greater understanding of how well the application process functioned and whether or not they have since been able to access the <£150k market.
- **Annual consultations with members of the Programme Partnership** to gain their reflections on programme-level developments.

1.2.2 Activity completed to date

This report draws on the following research:

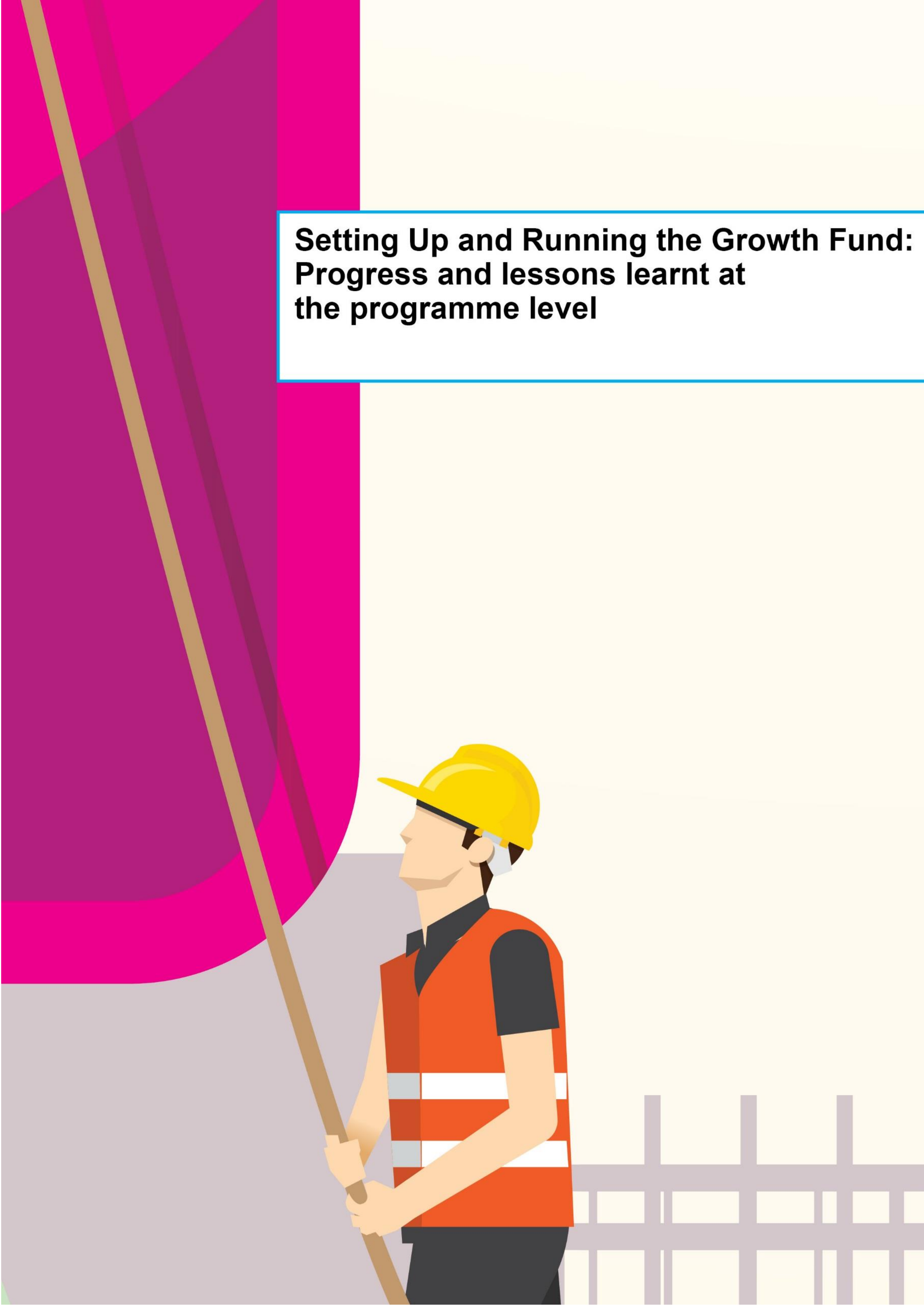
- **Semi-structured interviews with 11 social investors** to capture their views on the Growth Fund application process, their experiences of setting up the Fund, and their reflections on delivering the Funds to date. Only one of the twelve (then live) social investors could not be reached, so they did not take part in the research.
- **Case studies at the baseline stage with three VCSEs**, drawing on the perspectives of managers and delivery staff to ascertain their perspectives on the application process and their experiences of receiving and using social investment so far. All three VCSEs were from 'Efficiency' social investors.
- **Semi-structured interviews with the Programme Partnership**, which aimed to gather members' views on the progress of the Growth Fund to date, including any lessons learned.
- **Learning workshop with the social investors**
- **Analysis of quarterly data returns** containing information on 277 VCSE applications.

1.3 Report structure

The report is structured as follows:

- **Chapter 2** focuses on setting up and running Growth Fund at the programme level, and identifies lessons learned and recommendations.
- **Chapter 3** highlights social investors' experiences of operating within the Growth Fund
- The **Conclusion** pulls together all the key findings from across the report and provides recommendations.
- **Glossary:** The report includes a set of technical terms, and this glossary provides definitions for these terms, drawing on the Good Finance glossary. Where they are first used, there is a footnote with a definition for the term.

Setting Up and Running the Growth Fund: Progress and lessons learnt at the programme level



Summary

Programme Partnership

The Growth Fund is an innovative and novel partnership working to make social investment available to VCSEs who have not been able to access it before; it is therefore not surprising there have been challenges in implementation.

Implementation challenges were compounded by two factors:

- **Complex nature of the Programme Partnership** (i.e. the requirements of three diverse partners to collaborate whilst addressing their respective accountabilities); future similar programmes would benefit from channelling the grant and loan to the social investors through one organisation.
- **Lack of clarity on the roles and responsibilities in the decision making process during both the set up and delivery of Growth Fund**: We would encourage the partnership to focus on the Growth Fund Management Group as the vehicle for delivery decision-making

Range and structure of investment funds

The programme had achieved its aim of encouraging a wider group of organisations to become social investors and offer blended finance below £150k. Many stakeholders interviewed were excited by this development.

The social investment funds were structured so they would largely be able to cover their costs through income from interest and fees after 12 to 18 months with the grant supporting early operating costs. Deployment challenges meant some social investors struggled to achieve this, affecting their financial stability. The way the funds were structured was therefore seen by some as a “profound mistake”. Programmes deploying grant and loan funds to newly-established social investors should be structured with more flexibility, so that their financial sustainability is not so closely tied to early deployment of funds.

There was some disappointment in the (limited) degree of loan-product innovation across the programme. Whilst there are some innovative products on the margins of the Growth Fund, typically most Growth Fund social investors are offering VCSEs an unsecured, fixed-term loan with an interest rate of between 6 and 12%.

Portfolio management

The resources required for managing the portfolio of social investment funds had been under-estimated.

Some social investors felt Access could play a greater role in supporting cross-fund joint activity between social investors, such as running joint marketing activities.

This chapter focuses on the setup and running of the Growth Fund at a programme level. It considers the overall design of the programme, and the strengths and lessons learnt in setting up and running the programme. Some aspects of the application process, such as the due diligence, are covered in the following chapter. This chapter’s evidence is primarily drawn from semi-structured interviews with stakeholders from the three organisations in the Growth Fund’s Programme Partnership.

2.1 The Programme Partnership

The most important contextual factor to be aware of when reviewing the Growth Fund is its degree of novelty and innovation. The Growth Fund's Programme Partnership consists of three organisations working together in a new way. At the beginning of the programme, Access was a new organisation, and consequently it had no experience of managing blended finance programmes. The three organisations are also set up very differently, with different governance structures. The three organisations had never worked together in this way before. Furthermore, the partnership is working with a range of social investors, many of whom have never managed investment funds. Finally, these social investors are aiming to lend to VCSEs that also have limited experience of receiving loans.

> *"You're talking about three organisations with separate governance arrangements, even if they have a common aim."* (Programme Partnership stakeholder)

Therefore, it was inevitable that the stakeholders would need to learn as they went along, would make mistakes, would not have the foresight to plan for every challenge, and would not always agree on the solution to different challenges; and so it is not at all surprising that these things occurred.

At times the Programme Partnership worked very well; the three partners felt their principles were aligned and that they shared a vision in terms of what the Growth Fund was trying to achieve (though at a granular level there have been differences). This had benefits: in most instances the partnership was able to agree quickly which social investor applications should progress to further development and which should not, and this saved everyone considerable time. Furthermore, when the partnership faced significant challenges, such as how to respond to social investor under-performance, they found their views generally aligned. In addition, the partnership felt the Joint Investment Committee was operating very well.

Lesson learnt: It is important to make a decision early about whether an organisation's social investor's fund application should progress.

However, there was a broad consensus that the partnership structure was overly complex - in particular, with regard to the need for multiple agreements to be made between the three different organisations and the social investors. The social investors had a grant agreement with The National Lottery Community Fund and a loan agreement with Big Society Capital; both of these agreements were co-dependent, and changes in one largely affected the other. Furthermore, neither The National Lottery Community Fund nor Big Society Capital had direct relationships with the social investors; instead all communication was managed through Access.

Whilst the Programme Partnership has been effective at making decisions at the macro level (i.e in the JIC), this complex structure has made the lines of communication and decision-making at the operational level complex. This is further accentuated by the different lines of decision making within the three organisations. This compounded some of the challenges the partnership faced, in particular with regards to legal and commercial decision-making, and explained some of the inefficiencies experienced by the social investors in the application process (see Chapter 4).

> *"It's so complex as a structure."* (Programme Partnership stakeholder)

This highlights a key lesson learnt for future partnerships of this nature.

Lesson learnt: There need to be clearer decision-making processes between the organisations who lead a blended-finance market-building programme, to translate their high level decisions into operational execution

Multiple stakeholders reflected that another solution to this challenge would be for the same organisation to be responsible for, and deploy, the grants and loans to the social investors. The social investors would then have one agreement with one organisation that they could communicate directly with. It would remove any complexity arising from changes to one agreement affecting another agreement and organisation.

> *"In an ideal world you would have an organisation that gives both loans and grants out."* (Programme Partnership stakeholder)

Lesson learnt: It is simpler for the programme partnership and social investors if the grant and loan is deployed through the same organisation.

2.2 The range and structure of the investment funds

2.2.1 Range of investment funds

There was a consistent view across the Growth Fund's programme-level partners that it had achieved its aim of encouraging a wider group of organisations to become social investors and offer loan and grant packages below £150k. In particular, the Programme Partnership was pleased with the introduction of sector-specific and membership organisation social investors who, the Partnership believed, would be able to reach a wider set of VCSEs and 'debunk' some of the myths attached to social investment. It was for this reason that many described the programme as "*exciting",* as they believed it had been set up in a way that would enable it to achieve it aims. The following chapter provides more information on the range of social investors involved.

> *"They are new organisations...who wouldn't have operated in this space."* (Programme Partnership stakeholder)

> *"It's exactly what I thought we wanted."* (Programme Partnership stakeholder)

Whilst everyone agreed that the programme had the right *range* of social investors, some questioned whether it had the right *balance* between the different social investor types. Some were of the view that the fund needed more established social investors and fewer that were new to loan deployment; they believed the large number of newer organisations was contributing to the operational challenges, described further in this section.

2.2.2 Fund structure

The social investment funds were structured so they would largely be able to cover their costs through income from interest and fees after 12 to 18 months with the grant supporting early operating costs. This becomes challenging when the social investors significantly under deploy against plan; if this continues for some time and/or is relatively high compared to the amount of loans deployed, this can impact the financial position of the fund and the social investors' ability to repay BSC and any coinvestors.

With the benefit of hindsight one member of the Programme Partnership described this focus on early deployment as a "*profound mistake*". As described in the following chapter, over half of the social investors struggled to hit their original deployment projections (though some did re-profile and feel on track with their new projections). This therefore reduced the revenue they generated through their loans, diminishing their ability to cover their operational costs. In one extreme case, the social investor used the Big Society Capital loan capital supplied in the Growth Fund to fill the gap in operational costs, pushing the fund into more debt and risking it being shut down. The main issue was the assumptions in the deployment figures, but this issue was amplified because of how closely the fund's sustainability was tied to its ability to deploy. This highlights another key lesson learnt for both the remaining management of the Growth Fund, and for future funds.

Lesson learnt: Programmes deploying funds to newly-established social investors should be structured with more flexibility, so that their financial sustainability is not so closely tied to early deployment of funds. Slower-than-anticipated deployment should be carefully managed to reduce the financial risk it places on funds.

2.2.3 Products

As Ecorys identified in its Social Investment Rapid Evidence Assessment for Big Society Capital (currently unpublished, awaiting sign-off), increasingly stakeholders have argued that the social investment sector needs to offer a broader range of investment products to meet VCSE demand, such as providing more patient capital. Although the Growth Fund programme-level partners were satisfied with the range of *social investors* within the programme, there was some disappointment around the range of *products* available; Whilst there are some innovative products on the margins of the Growth Fund (for example, quasi-equity[16] elements, as mentioned in Chapter 2), typically most Growth Fund social investors are offering VCSEs an unsecured, fixed-term loan with an interest rate of between 6 and 12%.

> *"We have not seen many applications which propose to offer any alternative product, such as a risk product, rather than a simple loan."* (Initial observations on blending debt and grant from the Growth Fund)

> *"The Growth Fund isn't solving the challenge of designing repayable finance products. It's more about the same kind of funding mechanism."* (Programme Partnership stakeholder)

[16] Quasi-equity investment: a hybrid of equity and debt investment. Equity investment may not be possible if an organisation is not structured to issue shares. A quasi-equity investment allows an investor to benefit from the future revenues of an organisation through a royalty payment which is a fixed percentage of revenue. This is similar to a conventional equity investment but does not require an organisation to issue shares

Several Growth Fund social investors argued that the Growth Fund was not designed in a way that would foster loan-making innovation. In particular, the way in which the application form asked social investors to state the *one* product they would be offering, did not imply to them that the Programme Partnership was interested in social investors offering a wide range of products. Secondly, social investors argued that the 5% interest they themselves had to pay back on the loan from Big Society Capital hindered their ability to offer more innovative products; a challenge that faces the wider social investment market.

This highlights another key lesson learnt for funds of this nature.

Lesson learnt: If the fund wants to achieve loan-product innovation then this needs to be built into the design of the programme and the structuring of the wholesale capital offer

It should be noted however, that product innovation was a secondary aim of the Growth Fund; the primary aim being to provide access to unsecured debt, which is being achieved.

2.2.4 Putting it into practice

The Growth Fund's programme level partners reflected that whilst they had worked well in designing the Growth Fund, they had done less work upfront on how the funds would then be set-up. There were a number of areas that had not been fully considered at the beginning, such as for example the flow of money and which bank accounts would be used for the money.

The partnership was able to reach a broadly satisfactory agreement on all of these elements. However, there was an element of 'learning by doing' during the set-up of the funds, and some of the early funds bear the scars from this process. This was exacerbated by the challenges in the operational-level decision making process, as highlighted earlier, which at times made it a drawn-out process. These two factors combined meant the social investors found the process following their successful application to be challenging at times, as we discuss in the following chapter.

> *"A whole load of questions needed answering and this wasn't what people were talking about at that point."* (Growth Fund programme level partner)

Lesson learnt: Spend more time upfront in planning through the finer details of the fund structures and processes for operational-decision making.

2.3 Portfolio management

2.3.1 Resources

By the beginning of 2018 the Growth Fund had 10 funds in operation, and so the programme shifted from the set-up phase to portfolio management. The Growth Fund programme-level partners had assumed that this would be a lighter-touch phase than setting up the programme, and the funding for Access from The National Lottery Community Fund was structured so that it tapered down as the fund moved from the investment period into the portfolio management period.

The partnership's experience of delivery to date suggests that this assumption was incorrect. Challenges related to delivery, such as difficulties in deployment, compliance with the External Delegation Agreements (EDAs) and social impact reporting, have all meant that the delivery phase has been far more resource intensive for some members of the Programme Partnership than expected. As highlighted previously, this has been compounded by challenges in the decision-making process, a lack of clarity over the roles and responsibilities among the Programme Partnership and, in the view of some, the large number of newly-established social investors that require large levels of support.

> *"It has proven to be way more complex than we thought… We really didn't address the complexity of portfolio management, and who would do what."* (Growth Fund programme level partner)
>
> *"If anything more time is being spent on Growth Fund now than in the first two years."* (Growth Fund programme level partner)

Lesson learnt: Running a market-building fund of this ground-breaking nature takes more resource than may be initially anticipated, due to challenges faced during delivery

The JIC established a Growth Fund Management Group in the hope that this would enable the programme level partnership to work through some of the complexities and create a forum that enabled collective decision-making. We would encourage the partnership to focus on the Growth Fund Management Group as the vehicle for delivery decision-making.

Recommendation: Prioritise establishing the new ways of working of the Growth Fund Management Group

2.3.2 Role of Access

As described in the Introduction, Access' role in the Growth Fund is to manage the fund's collective operations in a wholesale capacity and to work with the social investors. Access' role is to support and monitor the social investors, while the social investors themselves are responsible for the loan and grant activity, including marketing.

At the social investor learning workshop, the social investors reflected that there could be benefits in Access acting more as a convener of market engagement work across the social investors, bringing benefits of economies of scale. Some social investors felt they were all operating on limited budgets, and quite a few were operating in the same geographical space (particularly the North West). This meant they were all undertaking similar activities with similar organisations, such as all running the same marketing activities targeted at the same audience. They reflected that there could be value in Access taking on a larger role here, helping convene the social investors working in the same space and running Growth Fund-wide marketing and engagement activities. This would add value, especially since many social investors have been struggling with achieving the levels of market engagement necessary to see conversion of interest among VCSEs into a sufficient early flow of viable propositions through their pipelines. Whilst Access (and BSC) has invested in Good Finance[17], which promotes social investment more broadly, social investors felt this additional activity would promote the Growth Fund funds more specifically. However, considering Access has a limited (ten-year) life, this is not necessarily a sustainable solution.

Recommendation: Access to consider playing a market engagement convener role where numerous social investors are operating in the same space

2.4 Conclusion

The Programme Partnership was broadly satisfied with the structure of the Growth Fund. The Fund had enabled a new and broad range of social investors to enter this space and offer something that, previously, VCSEs were unable to access. The partnership was excited by the prospects that this brought. Stakeholders were broadly content with the structure of the funds, though there were lessons learnt for either future programmes or the remainder of the Growth Fund in how they account for possible delays in deployment and how they encourage the development of more innovative products.

Whilst members of the Programme Partnership were pleased with the structure of the programme, the process to reach this point had, at times, been difficult. This is to be expected, given the innovative nature of both the programme and the partnerships involved. The experience highlights some useful lessons learnt for future organisations considering offering a blended finance or market stimulus and subsidy programme.

[17] https://www.goodfinance.org.uk/

Working with Social Investors in the Programme

Summary

The Growth Fund explicitly sought to diversify the number of social investors providing repayable loan finance and, succeeded in attracting a diverse range of applicants.

The application, approval and post-approval process proved to be lengthy and challenging for all applicant social investors, mainly due to the complex legal arrangements between the social investors, Access, Big Society Capital and The National Lottery Community Fund.

However, one advantage of the length of time taken and the rigour of the due diligence process, especially for new social investors, was improved plans.

There are some relatively simple actions at the Fund level for any future small-scale and higher-risk or unsecured-loan market-building programmes to take:

- Greater use of templates (such as contract and loan templates) to prevent duplication and help keep negotiations simple
- Design of a value-adding due diligence process that reflects fully organisations' respective starting points
- Setting clear expectations over legal agreement requirements to ensure no surprises that can otherwise affect trust in the long-term relationship between Fund and social investor.

It is also noteworthy that such support is needed in addition to social investors' own support offer; their business models are typically geared to provide intensive support too, such as from Investment Managers, Impact Managers and Investment Committee members, and so have a relatively high unit cost in-built.

In this chapter we outline social investors' experiences of applying to the Growth Fund, drawing on the interviews with social investors and the social investor learning workshops. Further information on the investors' experiences of deploying loans and working with VCSEs can be found in the 'Experiences of Social Investors and VCSEs' Update Report.

3.1 Characteristics of social investors

Table 1.1 provided a summary of the key characteristics of those social investors interviewed, but for ease of reference it is included again below (**Table 3.1**). When considering the findings outlined in more detail below, it is worth bearing in mind several key differences between social investors as follows:

- Those interviewed had launch dates ranging from July 2016 to May 2018, which means that the launch-experience findings look across both established and more recent entrants
- Only Big Issue Invest has a national (England wide) remit and no thematic limitation
- Others have either a geographical remit and / or a thematic remit, which limits the scope of potential organisations that they are targeting their lending towards
- Some social investors are also introducing loans into new sectors and, through this, supporting those VCSEs looking to diversify income beyond grant funding.

Table 3.1: Live social investor funds

Name of social investor and fund	Name of fund	Remit	Fund Established Date	Approved Total Fund Size	Approved A: Operating cost subsidy	Approved B: Grant for Loans to VCSE	Approved C: Grant passed on as grant	Approved Access total	Approved: Loan component from BSC	Approved: Co-Investment
Key Fund	Northern Impact Fund	North of England and Midlands regions with a thematic focus on newer ventures or business activities and first time users of social investment financing	19/09/2016	£5,359,489	£200,000	£1,358,589	£1,104,000	£2,662,589	£2,696,900	
Big Issue Invest (BII)	Impact Loans England	England wide remit and no thematic focus	20/12/2016	£5,067,438	£140,000	£1,300,844		£1,440,844	£3,626,594	
BII	Impact Loans England (II)	England wide remit and no thematic focus	02/11/2018	£3,925,787	£125,000	£1,268,339	£228,000	£1,621,339	£2,304,448	
Homeless Link	Homeless Link Social Investment Fund	National remit with thematic focus on addressing issues of homelessness	19/05/2017	£4,483,338	£200,000	£1,075,000	£962,500	£2,237,500	£2,245,838	
First Ark	Invest for Impact	North West region with no thematic focus.	11/10/2016	£4,006,487	£170,000	£689,122	£1,080,000	£1,939,122	£2,067,365	
NESTA	Cultural Impact Development Fund	National remit with thematic focus on providing finance to socially-driven arts and cultural organisations	16/10/2018	£3,708,467	£120,000	£1,130,367		£1,250,367	£2,458,100	
Resonance	Health and Wellbeing Challenge Fund (South West)	South West region and thematic focus on health and wellbeing	19/07/2016	£3,414,355	£125,000	£775,504	£805,000	£1,705,504	£1,489,720	£219,131 (South West Academic Health Science Network)
Environmental Finance	PICNIC	National remit with a thematic focus on public parks, expected to	30/10/2018	£3,248,503	£119,500	£826,069	£300,000	£1,245,569	£2,002,934	

Name of social investor fund	Name of fund	Remit	Fund Established Date	Approved Total Fund Size	Approved A: Operating cost subsidy	Approved B: Grant for Loans to VCSE	Approved C: Grant passed on as grant	Approved Access total	Approved: Loan component from BSC	Approved: Co-Investment
		particularly target three city regions								
UnLtd	UnLtd Impact Fund	National remit with thematic focus on addressing barriers to employment and training	20/10/2017	£3,190,734	£133,000	£791,320	£420,000	£1,344,320	£1,846,414	
Sporting Assets	Sporting Capital Fund	National remit with thematic focus on sports organisations delivering social outcomes for communities	27/06/2017	£3,081,192	£105,000	£1,026,786		£1,131,786	£1,949,406	
Orbit Group and partners	Community Impact Partnership	National remit but targeted mainly on the areas covered by the partners (East Midlands, East, London, South East)	12/11/2018	£2,984,226	£120,000	£621,849	£472,500	£1,214,349	£1,769,877	
The SIB Group and Forward Trust	Forward Enterprise Fund	National remit with thematic focus on addressing issues of addiction recovery and/or people who are ex-offenders	23/04/2018	£2,053,302	£87,852	£542,544	£270,000	£900,396	£1,152,906	
Greater Manchester Centre for Voluntary Organisation (GMCVO)	GM Social Investment	Greater Manchester geographical area only and no thematic focus	10/07/2017	£2,035,237	£100,000	£492,452	£420,000	£1,012,452	£1,022,785	
Devon Community Foundation	Devon Social Investment Fund	Geographical focus on Devon, Plymouth and Torbay and all services except for	21/07/2017	£1,229,991	£55,800	£280,299	£270,000	£606,099	£323,892	£300,000 (Devon Community Foundation)

Name of social investor and fund	Name of fund	Remit	Fund Established Date	Approved Total Fund Size	Approved A: Operating cost subsidy	Approved B: Grant for Loans to VCSE	Approved C: Grant passed on as grant	Approved Access total	Approved: Loan component from BSC	Approved: Co-Investment
		health and wellbeing								
Kent Community Foundation	Kent Social Enterprise Loan Fund	Geographical focus on Kent and Medway, focusing on new and existing social enterprises	25/10/2017	£1,124,172	£50,000	£205,543	£252,000	£507,543	£0.00	£616,629
Somerset Community Foundation	Somerset Social Enterprise Fund	Somerset geographical area only with no thematic limit	17/08/2017	£1,095,784	£49,000	£67,178	£375,000	£491,178	£0.00	£604,606 (Somerset County Council)
Total Sum				**£50,008,502**	**£1,900,152.00**	**£12,451,805**	**£6,959,000**	**£21,310,957**	**£26,957,179**	**£1,740,366**

Source: Growth Fund Management Information

Another factor that differentiates the social investors is their prior experience of social lending and investment, as opposed to managing grant programmes. **Table 3.2** below shows the social investors who were interviewed in each category:

Table 3.2 Prior social lending experience

Experienced social investors	Grant management or some social lending experience
Big Issue Invest Resonance Key Fund Kent Community Foundation Social Investment Business	GMCVO UnLtd Sporting Assets Somerset Community Foundation[18] Homeless Link Devon Community Foundation

Source: Primary interviews conducted during June/July 2018

Given the differences between social investors, it is also interesting to note where their experiences (detailed below) have been *similar* across the board during the application process.

3.2 Social investor perspective and experience of application process

It is fair to report that none of the social investors experienced a completely smooth and straightforward application process.

All of the social investors interviewed recorded that the application process took at least 12 months from initial application to final signature of the External Delegation Agreement (EDA) and other agreements. The common experiences of the application process included:

- Duplicate requests for information i.e. the same information asked for in different guises
- Initial lack of contract and loan agreement templates and, for example, agreed wording for Board Minutes
- Challenges modelling loan-book forecasts within Grants A, B and C restrictions to arrive at a target Internal Rate of Return (IRR) and other grant restrictions
- Misconceptions or wrong expectations about legal requirements for finalising the EDA, described as "*late interventions*" by both Big Society Capital and The National Lottery Community Fund and "*shifting the goalposts*"
- Pressure to hire key staff before agreement signature.

Although this application process was *"long and arduous*", it should be noted that the experience for established social investors was not much different to that of applying to manage any other social lending fund.

There was also one key benefit noted by several of the social investors that were new to social lending of the time taken over the application and due diligence processes. The questions asked in the process allowed them to refine their proposals and give due consideration to governance, operational and other issues that needed sufficient time to think through carefully. In this regard, there was considerable value added in the process, as perceived by the social investors who were new to social lending.

[18] Though Somerset Community Foundation were already running a small loan fund

3.2.1 Learnings from the application stage for any future social investor building fund

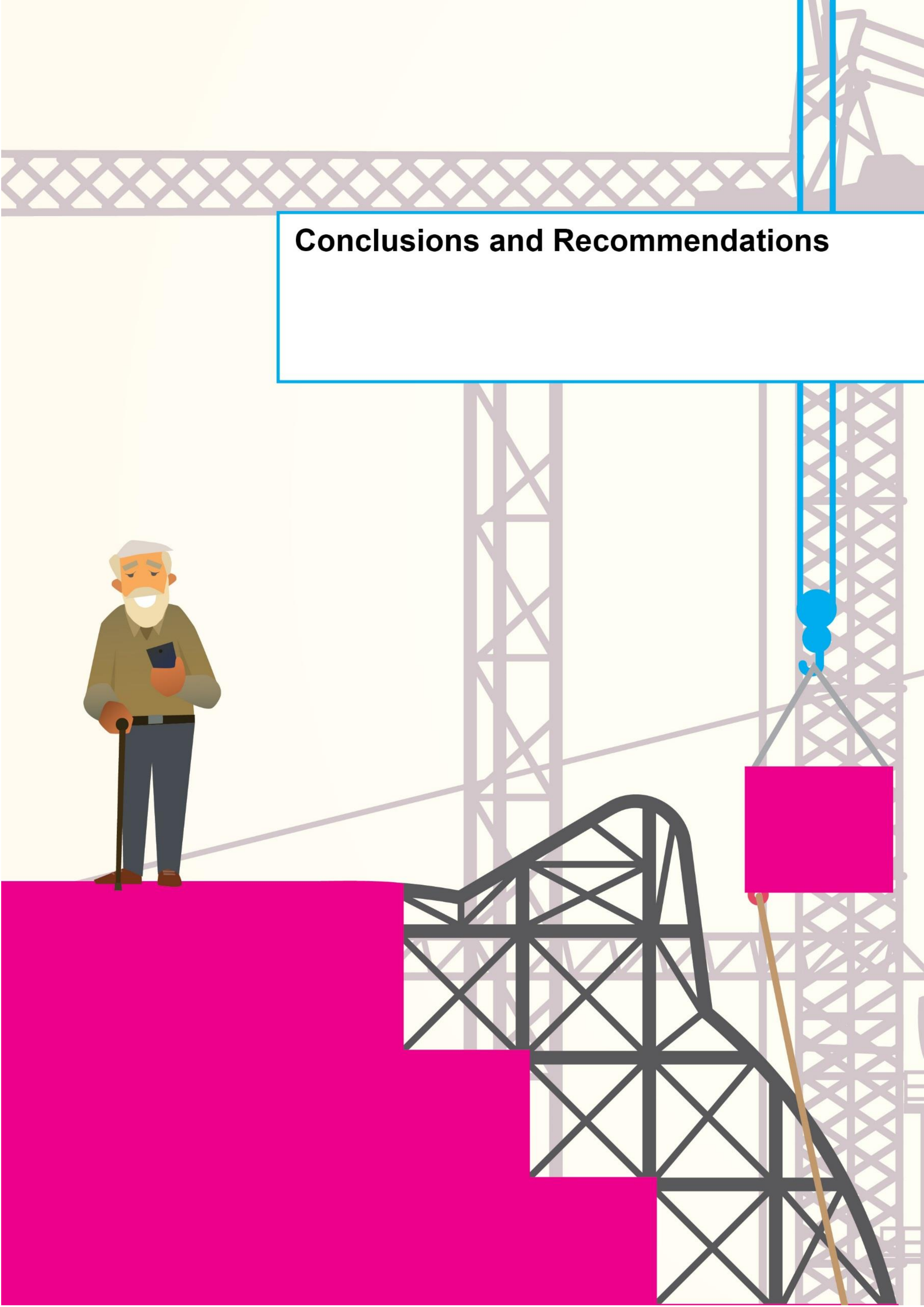
The main lessons are detailed below.

- Distribution of templates (e.g. contract and legal templates) and agreed wordings in advance will save time, particularly if they can be cognisant of the different organisation structures e.g. membership bodies
- There are considerable benefits to the due diligence process especially for new social investors. As far as practicable, due diligence needs to be adaptive to the social investor organisations - taking into account their starting point and experience so as to add the most value into the process
- The legal aspects of the process need to be clearly understood at programme level and then explained to investors to set expectations about the extent of work required to finalise agreements.

3.3 Conclusion

The Growth Fund has been successful in diversifying the number of social investors providing sub-£150,000 loan and grant packages to VCSEs. It has attracted a diverse range of applicants from established social investors such as Big Issue Invest and Key Fund through to sector specialists such as Homeless Link and Sporting Capital to Community Foundations and GMCVO (a voluntary sector umbrella organisation). The application, approval and post-approval process was lengthy and challenging for all of the applicant social investors, often due to duplicate requests for information, a lack of contract and loan agreement templates, difficulties modelling loan-book forecasts, complex legal arrangements, and pressures to hire key staff before agreement signatures. Despite these challenges, the questions asked, and clarifications required, during the due diligence process allowed social investors to refine their proposals and really think through key issues. This was beneficial for all social investors, but especially those who were new to social lending.

Conclusions and Recommendations



This chapter provides an overview of the conclusions and recommendations from the evaluation so far. It brings together the key findings from the first two Update Reports.

4.1 Revisiting the Growth Fund Theory of Change

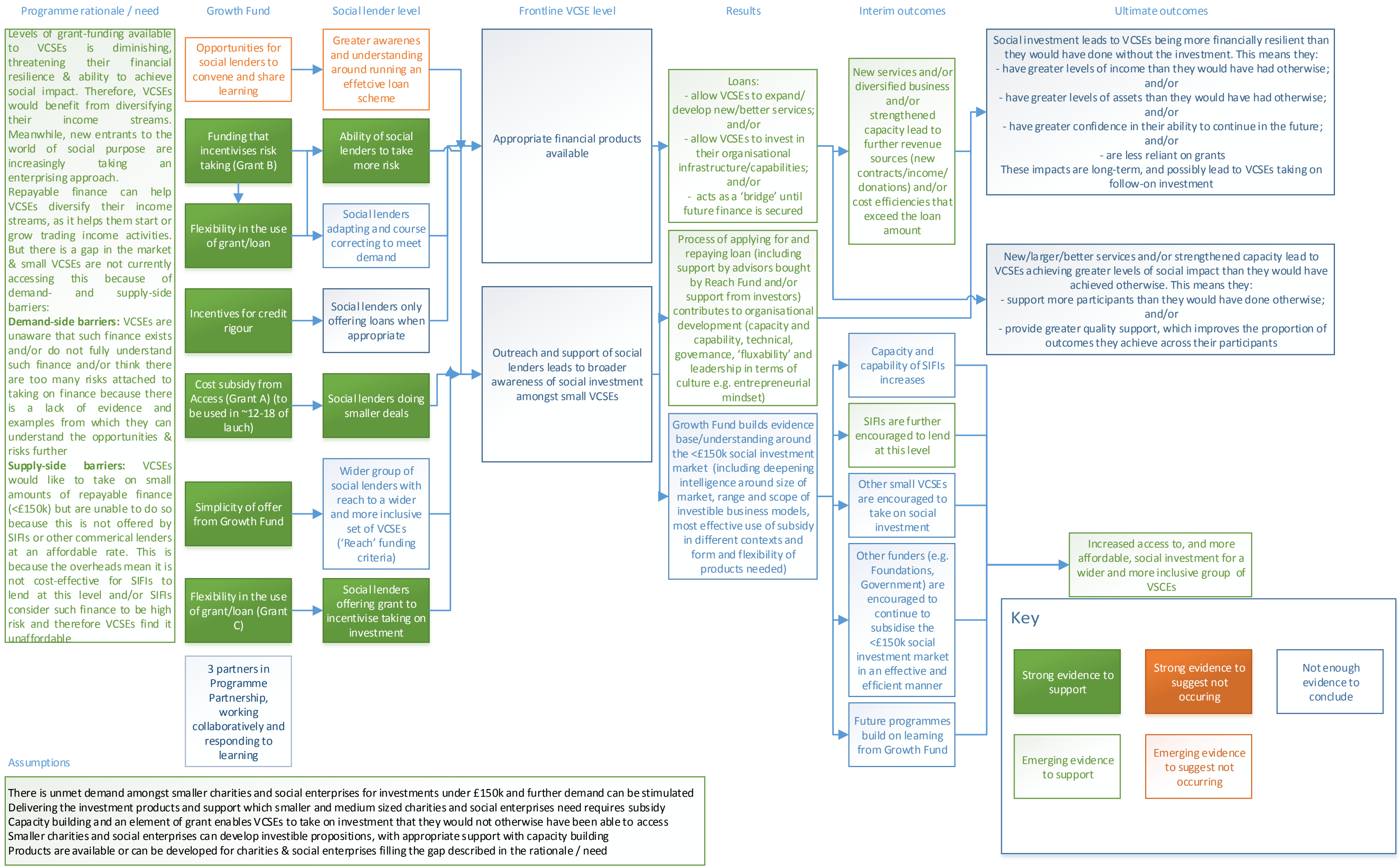
Figure 6.1 outlines the Growth Fund Theory of Change (ToC); this was amended part-way through the programme, recognising that the initial ToC would benefit from further detail. We have coded the ToC to highlight the areas that, based on the evaluation findings so far, appear to be proving correct or incorrect. We have also added in additional aspects that, with the benefit of hindsight, appear to be crucial elements to the programme ToC. In **Annex II** we have included previous versions of the ToC, so the reader can see how the ToC has evolved as stakeholders have understood the programme, and which factors are critical to its success.

The key points from this are:

- The programme rationale/need is proving to be correct, as the Growth Fund is demonstrating that there is demand for small-scale social investment, and that altering the form and reach of the loan offer from social investors enables this demand to be met. However, the demand appears to be more latent than expected – i.e. it is taking longer to identify this demand and bring it to fruition than initially anticipated.
- Most of the inputs at the Growth Fund programme level were being implemented as expected: the different levels of grant to social investors were being implemented as intended, and were incentivising risk and enabling social investors to administer repayable finance of a smaller value.
- The area where further consideration could be needed is around convening market-engagement opportunities for social investors; whilst there are good opportunities for them to share learning, there is a desire for more structured opportunities for them to convene stakeholder engagement on the ground and take advantage of economies of scale in collectively organising this.
- We have added the detail to the ToC that there is an expectation that Grant A will be used in 12-18 months, as this expectation appeared to be critical to the fund performances.
- We have added the input that the three partners in the Programme Partnership will work collaboratively and respond to learning, as this factor appears critical to the success of the Fund.
- There is strong evidence that some of the social-investor level activities are occurring as expected, such as social investors providing smaller loans. It is too early to tell whether social investors are course-correcting to meet demand – this will become evident in the next 18 months.
- It is also too early to tell whether the Growth Fund's full complement of social investors will be able to reach a significantly wider and more inclusive set of VCSEs. It is apparent that they are *targeting* VCSEs less experienced in taking on social investment, but the experience to date suggests that these VCSEs are further away from taking on social investment than initially anticipated.
- There is emerging evidence from the case studies that the loans and grants are being used in the ways intended, and are enabling VCSEs to expand and invest in their organisational capacity. They are also benefiting from their work with investment managers during the application process, as it is strengthening some of their business cases.
- There is not enough data to be able to report on how the Growth Fund has currently impacted on VSCEs' financial resilience or levels of social impact.
- The assumptions are proving to be broadly correct, with the following exceptions:
    - Whilst the Fund is certainly meeting unmet active demand, it has proven harder than anticipated to stimulate further demand from more latent interest among VCSEs

- Capacity and capability building support does indeed enable VCSEs to take on investment, but more support is still required directly from the social investors than initially anticipated
- Products have been developed to meet VCSE demand, but not the more innovative products which other research suggests is required to meet the full level of VCSE needs or demand.

Figure 6.1: Growth Fund Theory of Change revisited



4.2 Conclusion and lessons learnt

As one stakeholder commented, Growth Fund is "*doing what it said on the tin".* The findings reported in the first set of Update Reports suggests that it has encouraged new lending activity in an area of the social investment market where demand was not being fully met. It has enabled established social investors to offer something new by de-risking investments, and it has allowed new social investors to enter the space. The funds are providing the right type of loans and grants to the right type of organisations i.e. small-scale unsecured loans/grants to small VCSEs who have not accessed social investment before. The three case-study VCSEs looked at so far have had a positive experience. Many stakeholders are excited about what the Growth Fund will achieve. This is a very positive achievement.

This 'headline' achievement, however, masks many challenges. The Growth Fund is a complex and innovative programme and at times it has been difficult to implement. The social investors that are new to social investment have struggled with deploying loans, and their activity is below original projections. A lot of lessons have been learnt along the way, and these have been captured in this report and summarised in **Table 6.1** below. What is unclear at the moment is whether these challenges are fundamental issues and miscalculations around the level of demand for social investment and the speed with which it can be converted into viable deals, or whether they are early-stage teething issues that can be resolved with commitment and hard work.

Notwithstanding these difficulties, all of the established and newer social investors are themselves 'sold' on the concept of building the market through the two tiers of blended repayable finance (i.e. blending grant with capital for investors' operations and grant with loan for VCSEs). They are keen to make it work both for their clients and the social impact that they deliver, as well as for themselves

The next 18 months, as these challenges are worked through, will be a major test for the Growth Fund.

These challenges, and the things that were designed into the programme which have worked well, have generated points to note, which are summarised in the table below:

Table 6.1: Lessons learnt from the Growth Fund for organisations running repayable finance market-building and capital deployment programmes

1.	Spend more time upfront in planning through the finer details of the fund structures and processes for operational decision making.
2.	It is important to make a decision early about whether a social investor's fund application should progress.
3.	There need to be clearer decision-making processes between the organisations who lead a blended-finance market-building programme, to translate their high-level decisions into operational execution.
4.	It is simpler for the programme partnership and social investors if the grant and loan for the social investor is deployed through the same organisation.
5.	Programmes deploying funds to newly-established social investors should be structured with more flexibility, so that their financial sustainability is not so closely tied to early deployment of funds. Slower-than-anticipated deployment should be carefully managed to reduce the financial risk it places on social investment funds.
6.	If the programme partnership wants to achieve loan product innovation then this innovation needs to be built into the design of the programme and the structuring of the wholesale capital offer.
7.	Running a market-building fund of this ground-breaking nature takes more resources than may be initially anticipated due to challenges faced during delivery.
8.	Distribution of templates (e.g. contract and loan templates) and agreed wordings in advance will save time, particularly if they can be cognisant of the different organisation structures e.g. membership bodies.
9.	There are considerable benefits to the due diligence process, especially for new social investors. As far as practicable, due diligence needs to be adaptive to the social investor organisations - taking into account their starting point and experience, so as to add the most value into the process.
10.	The legal aspects of the process need to be clearly understood at programme level and then explained to investors to set expectations about the extent of work required to finalise agreements.

4.3 Recommendations

- **Re-examine the structure and assumptions of the new Growth Fund funds in the early stages and about to be deployed, to ensure lessons from the first funds have been learnt and applied to later funds:** The structure of the funds meant some funds entered into financial difficulty when deployment projections were not reached. If it has not been addressed, it is possible the new funds will face the same challenges. Whilst it is impractical to revise the whole structure of the funds at this point in the programme, it may be possible to explore some aspects, and we would encourage this.
- **Prioritise establishing the new ways of working of the Growth Fund Management Group:** The Programme Partnership has, at times, struggled to make congruent decisions in a speedy manner. This is due to the need for collective decision-making, brought about by the inter-twined agreements with social investors. The JIC established a Growth Fund Management Group in the hope that this would enable the partnership to work through some of the complexities and create a forum that enabled collective decision-making. We would encourage the partnership to focus on the Growth Fund Management Group as the vehicle for delivery decision-making.
- **Access to consider playing a market engagement convener role where numerous social investors are operating in the same space:** The social investors reflected that there could be benefits in Access acting as a convener across the social investors, bringing benefits of economies of scale. This is particularly pertinent where social investors are operating in the same geographical space, and particularly with regard to audience engagement. Whilst Access (and BSC) has invested in Good Finance, social investors felt this additional activity would promote the Growth Fund funds more specifically. However, considering Access has a limited (ten-year) life, this is not necessarily a sustainable solution.
- **Undertake detailed debriefing with social investors to understand and resolve gaps in social impact data. Spend more time with social investors and VCSEs well in advance of the next social impact data return to co-design a strategy to ensure there are fewer gaps in data**: The evaluation found multiple examples where reporting on impact by VCSEs to their respective social investor funder had not been easily set up. This is despite various of the social investors having Impact Frameworks for VCSEs to use in reporting back to them. This is reflected in the amount of missing social impact data the social investors provided to Access, and has meant the evaluation has been unable to report on changes in social impact data. We would recommend the Programme Partnership explores this issue in more detail with the social investors.

4.4 Areas for further research

Throughout the Update Reports we highlight aspects that require further research in order for the areas to be fully understood. We summarise those aspects here. We also indicate the extent to which these will be explored in future rounds of evaluation activity:

- How the Growth Fund and Reach Fund interact (addressed in remainder of evaluation), and the extent to which the Reach Fund supported VCSEs to become ‘investment ready’ (explored in part through this evaluation)
- What investors mean when they describe an application as being ‘unsuitable’ (addressed in remainder of evaluation)
- Why investors report they cannot make impact reporting a term of a loan, when it is possible to make this a term of grants (addressed in remainder of evaluation)
- Use of different loan and grant products, including ‘repayable grants’ (addressed in remainder of evaluation)
- The social investors’ experiences of managing the investment funds (addressed in remainder of evaluation)
- The economic and management models of the social investors, including the role of cross-subsidy from lenders’ other work (addressed in remainder of evaluation)
- Experiences of VCSEs receiving loans and grants from organisations newer to social investment (addressed in remainder of evaluation)
- Costs and resources required to apply for the loan and grant packages (addressed in remainder of evaluation)
- The extent to which VCSEs could have received funding (either grants or loans) elsewhere (addressed in remainder of evaluation)
- The impact of the loans and grants used for other purposes other than scaling up existing activity – such as for asset acquisition or refurbishment (addressed in remainder of evaluation)
- The impact of the social investment on VCSEs’ financial resilience and social impact (addressed in remainder of evaluation both qualitatively through the case studies and quantitatively if data quality issues highlighted in this report are addressed

Annexes

Annex I: Glossary

Below are list of definitions of terms used within the report. These definitions have been taken from the Good Finance glossary.

Asset: in relation to an organisation's accounts. a financial benefit recorded on a balance sheet. Assets include tangible property (i.e. a property with a physical form such as buildings, equipment and vehicles) and intangible property, and any claims for money owed by others. Assets can include cash, inventories, and property rights.

Capital: capital usually refers to financial capital or money and in particular the amount of cash and other assets held by an organisation.

Cash flow: the actual cash held by an organisation over a given period. A cash flow forecast shows the total expected outflows (payments) and inflows (receipts) over the year, usually on a monthly or quarterly basis. It is an essential tool for understanding where there will be shortages and surpluses of funds during the year and planning for ways to resolve these.

Co-investment: investment in a project or fund alongside and often on the same terms as other investors.

Financial returns: the monetary surplus generated by an organisation on an investment. It may be expressed as "net" (i.e. after deducting all expenses from the gross income generated by the investment) or "gross".

First loss: it is possible to have different tiers of investors so that one set of investors accepts that, in the event that the investee suffers financial difficulties, it will lose the money it invested before any of the other investors lose any money. This investor will bear the ‘first loss’.

Grant: a conditional or unconditional gift of money with no expectation of repayment.

Interest: fee paid by a borrower to a lender to pay for the use of borrowed money. When money is borrowed, interest is typically paid to the lender as a percentage of the amount owed. Interest usually accrues on a daily basis but is charged less frequently, e.g. monthly, quarterly or annually.

Investment readiness: an organisation having the systems, processes and business model to be able to attract investment.

Patient capital: loans or equity investments offered on a long-term basis (typically five years or longer). It is often used to describe long-term investment by investors looking for non-financial as well as financial gains and may be offered on soft terms (e.g. capital/interest repayment holidays and at zero or sub-market interest rates).

Quasi-equity investment: a hybrid of equity and debt investment. Equity investment may not be possible if an organisation is not structured to issue shares. A quasi-equity investment allows an investor to benefit from the future revenues of an organisation through a royalty payment which is a fixed percentage of revenue. This is similar to a conventional equity investment but does not require an organisation to issue shares.

Social impact: There is no one definition of the term or concept, but the social impact can be defined as the effect on people that happens as a result of an action or inaction, activity, project, programme or policy. The 'impact' can be positive or negative and can be intended or unintended, or a combination of all of these.

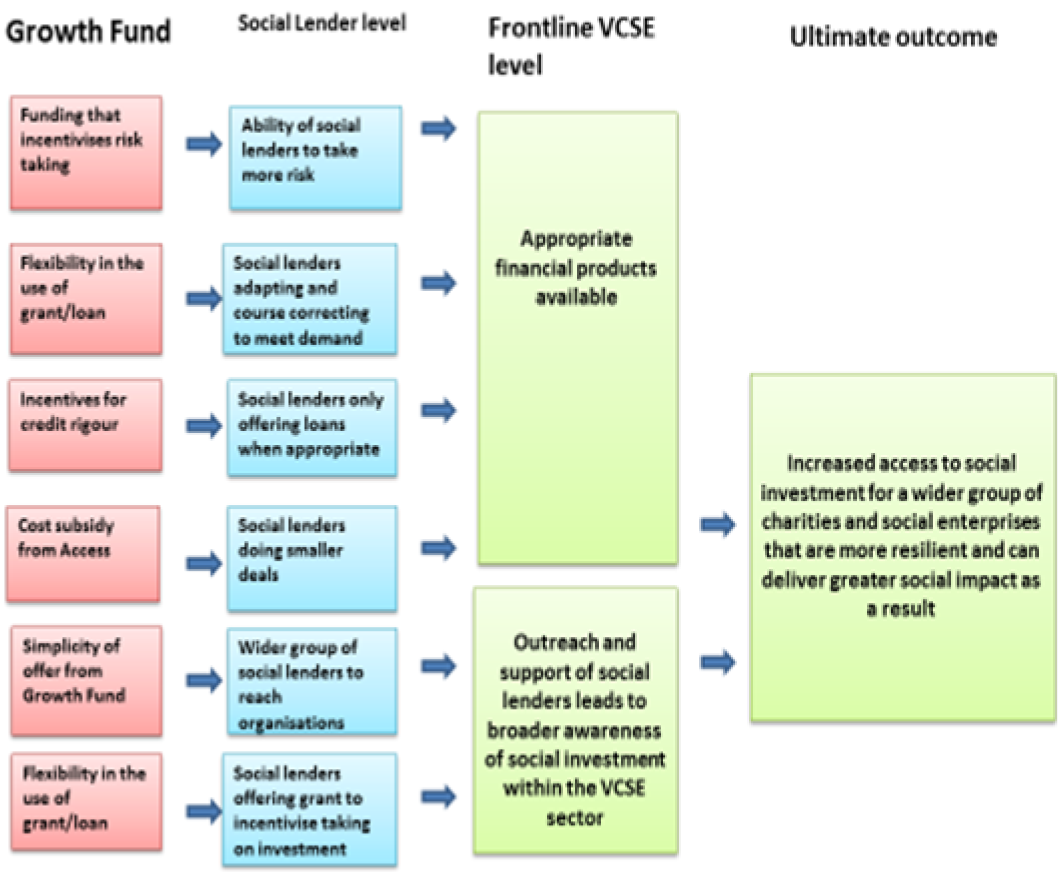
Unsecured loan: a loan that does not take security over an organisation's assets. Because the risk for the lender is greater, interest rates are usually higher than for secured loans.

Working capital: finance used to manage the timing differences between spending money and receiving it (income and expenditure).

Write-off: when all or part of the value of an asset (e.g. an investment) as shown in an organisation's accounts is reduced. In respect of an investment, this may occur when the investor considers there is no likelihood of any recovery of the amount invested.

Annex II: Previous Versions of the Programme Theory of Change

Original Theory of Change at programme launch



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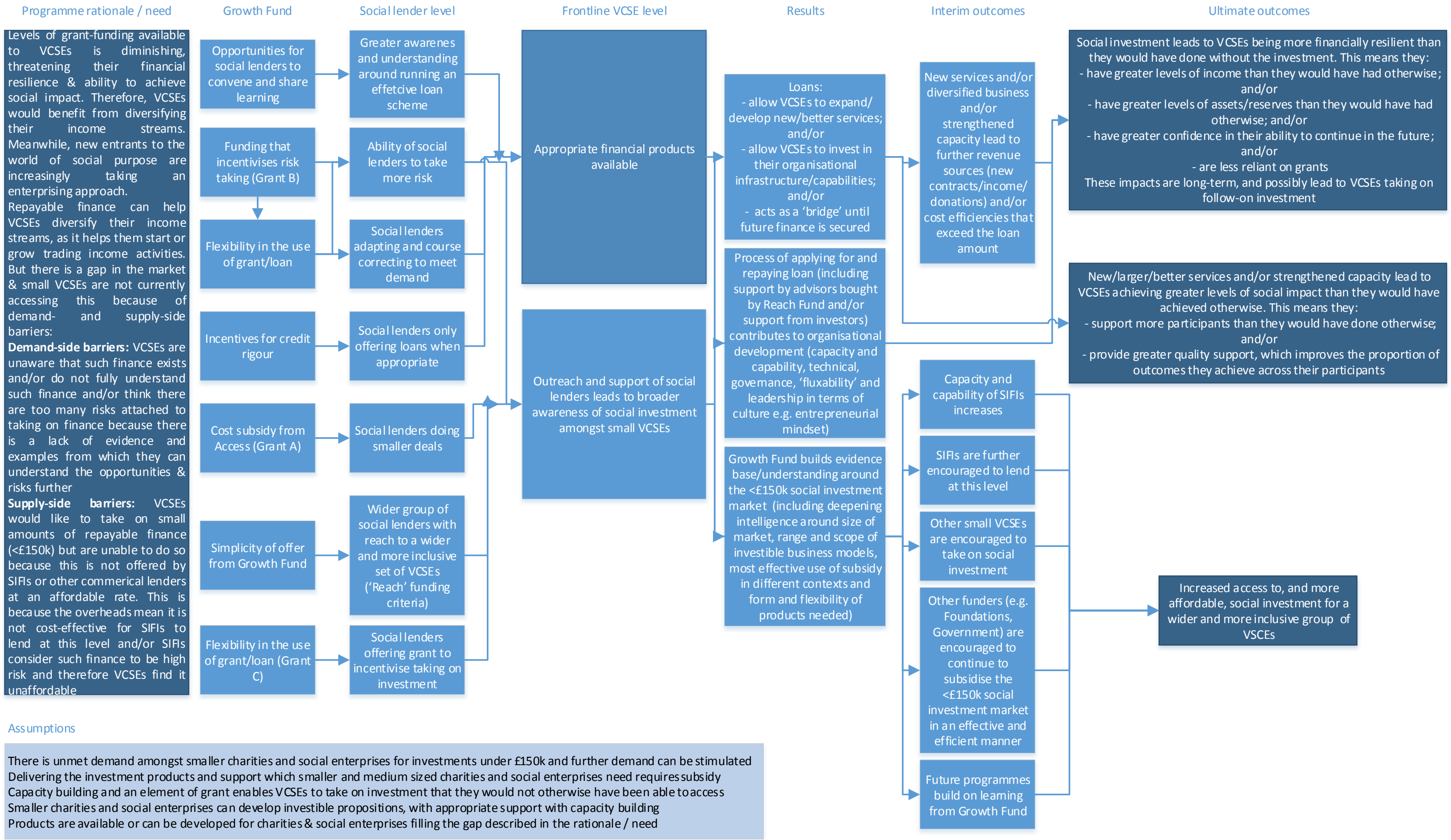
Revised Theory of Change



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