



social investment scotland

**INVESTMENT CAPITAL FOR
SOCIAL VENTURES PILOT :
EVALUATION**

Final Report

blue horizons

LOOKING FORWARD IN BUSINESS

November 2007



Equal

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1 EXECUTIVE SUMMARY

Background and Context

- 1.1 The Investment Capital for Social Ventures Pilot was initiated by Social Economy Scotland following the recommendations of Social Investment Scotland's (SIS) report Investment Capital for Social Ventures. The pilot reflected the view that there may be a need for finance for social ventures, particularly: patient capital, which could not be provided by commercial banks; and equity-like investment and even SIS existing loan products.

The pilot had the following aims:

- Assisting the formulation and costing of development plans for each enterprise; and
- Proposing funding solutions that contain elements of investment capital and loan finance.

The objectives of the pilot were to:

- Provide a role model for the sector; and
- Demonstrating in practical terms what is possible in the investment capital area.

- 1.2 The pilot was delivered in a reasonably competitive financing and funding environment which included five community development finance initiatives, Futurebuilders Scotland (currently being evaluated), and Big Lottery grants. The future environment will include at least one venture philanthropy initiative and one or more vehicles delivering the Scottish Investment Fund (see below).

- 1.3 The environment for social venture development in Scotland has been greatly bolstered by the Scottish Government's recent announcement of a £63 million development programme and a £30 million Scottish Investment Fund. The latter is designed to encourage greater investment in assets, business development and skills of those working in the third sector. The new administration has also adopted, and is driving, the Social Enterprise Strategy launched this year. Furthermore, the Economic Strategy for Scotland, launched on 11 November 2007, emphasises collaboration between the public, private and third sectors to achieve five key economic objectives. Hence, overall, the environment for developing social enterprise in Scotland has never been stronger and presents great opportunity.

Methodology

- 1.4 This evaluation was undertaken using a combination of desk research and face to face and telephone interviews with stakeholders, social ventures and SIS, leading to draft and final reports.

Research Results

- 1.5 Policy and support environment: There is a clear intention by the Scottish Government to promote investment in, and support for, social enterprise. SIS is a possible delivery vehicle for part or all of the new Scottish Investment Fund. Big Lottery and other charitable foundation grants will continue, and there may be an opportunity through the Scotland Funders Forum to influence how these grants are used.
- 1.6 Social return on investment (SROI): There is ongoing work to identify social return on investment (SROI) and also predictive SROI. Identifying and quantifying social return is

very important, as that return is the justification for investment at below market rates, or where there is a higher than normally acceptable risk.

1.7 All except one of the existing social ventures who participated in the pilot were interviewed. The following is a summary of the results:

- 2 had secured SIS pilot funding packages.
- 2 had formal SIS pilot funding packages offers currently under consideration.
- 1 had an offer of SIS pilot funding, which could be progressed once a planning issue has been resolved.
- 2 had reached the offer stage, but decided not to proceed. In one case this was because the decision was made not to proceed with the venture itself. In the other, the business was able to access the capital it needed elsewhere partly because of the development work they had undertaken with SIS.
- 4 succeeded in acquiring the funds they needed elsewhere before reaching an offer stage.
- 1 went into liquidation early in 2007.
- 1 did not proceed after receiving initial feedback from SIS on its proposed ventures.

The following summarises the key points from the interviews:

- There were variable levels of awareness of the availability of different kinds of finance, and the type of financial package required varied by client. These things meant that SIS needed to undertake considerable work with potential investees and to develop a unique financial package, sometimes with other lenders or investors. In two out of the twelve enterprises interviewed, other commercial lenders made finance available as a result of SIS involvement. One venture stated that other alternative finance providers had been unable to offer them the scale of financing they needed and that the finance they had obtained from SIS had enabled them to remain in business.
- Some enterprises felt able to produce high quality business plans to investment-ready standard themselves but more stated that they needed assistance with this.
- Half the interviewees were happy with the process, timescales and guidelines involved in working with SIS. The other half raised some issues regarding the speed of progress and a desire for greater clarity at the start of the process. It appeared that social ventures involved later in the pilot were more satisfied than earlier participants. This suggested that SIS have learned from their early experience.
- Nearly all of the ventures interviewed were aiming to become completely self-sustaining, believed that grant funding was a useful way of initiating new ventures but also felt that once ventures build their own income they should seek loan and patient capital funding solutions for greater sustainability.
- Some interviewees felt that grants should be made available over the long-term for voluntary providers of essential support services that could not generate significant income.
- The ventures interviewed were all aware of the need to identify social return and measure it, but most needed help with finding appropriate measures.
- Almost all of the ventures interviewed were happy with the support and service they had received from SIS. Those which would have liked more clarity at the outset, and faster

progress, nevertheless expressed satisfaction with the support they had received from SIS. One venture registered dissatisfaction and this related to lack of clarity.

1.8 The summary of interviews with stakeholders and SIS were as follows:

- Interviewees generally complimented SIS on their high level of professionalism and commitment. One noted that they had worked hard to develop financing solutions other than traditional loans, and another that they had achieved exceptional levels of client satisfaction.
- Clearer communication between SIS and members of Social Economy Scotland on the pilot's precise purpose would have created greater understanding and strengthened a partnership approach.
- Some stakeholders believe that SIS could have been more innovative in funding solutions applied. In fact, the financial packages demonstrated that most elements of patient capital had been used in one or other of them.
- There may be a need to widen the recognition among stakeholders that where SIS provides pre-investment support, and the venture subsequently obtains finance or funding elsewhere, this is a successful outcome.
- Some stakeholders suggested that SIS could have made greater use of grants within the pilot to raise the level of demand. It was acknowledged that interest would, in some cases, be waived where social targets were met, but some interviewees felt that a greater subsidy, of between 25% and 50%, would have offered more incentive.
- Other interviewees suggested that loan and patient capital could be used together to build long term sustainability amongst income-generating social ventures. One made the point that grants can play a vital role at business start-up, by reducing the need for loans, reducing the risk carried by investors and encouraging social enterprises to test a business idea.
- Some stakeholders felt (as did some ventures) that applications could have been processed faster.

Conclusions

- 1.9 The pilot has been effective in delivering its stated aims and objectives. Two investments have been made, and three more are likely by early 2008. While the purpose of the pilot was not to place a particular amount of capital, so far £70,000 of patient capital investment within total commitments of £200,000 has been placed, and pipeline investment is up to £550,000.
- 1.10 These investments demonstrate that social ventures in Scotland need access to finance which: is an appropriate mix of grant, equity or quasi-equity; is affordable; matches repayments to income, and takes account of social benefit. This project does not, and was not designed to establish the extent of this demand.
- 1.11 Delivery methodology has been generally effective, though it took time to process applications. It appears that SIS have learned from their experience, as more recent applications have been processed more quickly.
- 1.12 The range of investment mechanisms tested cover those available within a patient capital model.
- 1.13 There is a need for social enterprises to better identify their measurable social return. SIS adapted a balanced scorecard mechanism conveying four distinct elements; one of which is social return; to their needs and are planning to use it with all applicants, including those to its core fund.
- 1.14 The SIS team have the requisite expertise and experience needed to run the pilot. The criteria applied in assessing whether or not ventures should receive investment were reasonable and appropriate.
- 1.15 Although it is too early to assess long term outcomes from recent pilot investments, there is one venture that would have ceased trading without the pilot funding.
- 1.16 The strengths of the pilot are as follows:
 - It led to non-grant financing of two social enterprises which had not been able to access the capital they needed to develop their businesses (likely to be four by the end of 2007 and five by early 2008).
 - It demonstrated that there was a demand for non-loan financing for social enterprises.
 - It confirmed that the financing needs and available security of social ventures vary greatly and that different financing packages were needed for each.
 - It showed that if a social venture is interested in accessing financing, instead of grant funding, it is likely that experience in identifying a specific product appropriate to its needs (loan, equity investment or quasi-equity) will be limited.
 - It identified that most social ventures lack experience in preparing investment ready business plans which can be accepted without alteration as a basis for financing.
 - It showed that social enterprises and their advisers were not always fully aware of the needs of SIS in terms of the content of business plans.
 - It showed that although many social enterprises understood and were motivated by social return, they did not necessarily have mechanisms in place for measuring their social outcomes.

- It showed that a comparatively simple form of measurement of social return on investment, the balanced scorecard, could be used to underpin financing for social enterprises at below commercial rates.

The pilot's weaknesses are as follows:

- It was not designed to identify the level of latent demand in the sector and did not do so. This must be done if substantial resources are to be allocated to it in future.
- It did not incorporate enough provision for detailed reporting to stakeholders to ensure they were aware of its precise purpose and its achievements. Although progress reporting was undertaken via the Access to Finance Thematic Board, interviews suggest that greater emphasis on detailed reporting to stakeholders would have been helpful.
- Earlier investments were slower than clients would have liked or expected. This may have arisen as a result of a mismatch between the information presented by some clients and the needs of the SIS team. Steps have now been taken to address clarity and identify clear processes from the outset.

Recommendations

The detailed recommendations in the report can be summarised as follows:

1. That policy-makers consider the value of the SIS approach as a route to achieving the objectives of its economic strategy, and in particular addressing its strategic priorities of a Supportive Business Environment and Equity:
 - a. By assisting social enterprises in key sectors, as identified in the strategy and in the forthcoming key sectors report, where support can make them considerably more successful than would otherwise be the case, and
 - b. By assisting social enterprises offering supported employment.
2. That policy-makers consider contracting SIS to deliver a significant part of the Scottish Investment Fund in the form of patient capital and other risk products.
3. That, in addition to recommendation 1, policy-makers ensure that a proportion of any new capital be made available without targeting, to allow SIS to assist the social economy as it moves to take advantage of market opportunities, as a way of developing an enterprising sector.
4. SIS ensures that it has or obtains an appropriate quantum of funding ability that creates the ability to provide or help assemble financing packages which should include a mixture of loans, patient capital, risk capital involving greater risk taking for greater social return, and targeted use of grants.
5. SIS includes development grants as part of a package where the grant is needed to make the package work, compensates for high social return, is needed to help develop strategies and business plans and is required during start up when the risk is too great for venture philanthropy.
6. SIS holds discussions with grant-makers, through the Scottish Funders Forum or otherwise, regarding the scope for grant funders to:

- Advise prospective applicants that where they may be able to operate commercially, an application for financing might be more appropriate.
 - Offer grants which assist social ventures to become investment-ready.
 - Make grants available on a declining scale to social ventures that are accessing financing (from SIS or elsewhere), where they need time to develop their income-generating activities to a level which pays for their socially-beneficial activities.
7. SIS discusses other grant awarding bodies' experience in providing grants to support early stage enterprises (e.g. Futurebuilders England) and holds discussion with other providers (e.g. Lloyds TSB Foundation and Big Lottery) regarding direction of grants to assist social enterprises reach the point of ability to repay borrowings.
 8. SIS take into account the conclusions of the Futurebuilders Scotland evaluation in designing its future product offering.
 9. SIS continues to review its procedures for assessing applications to simplify and speed up the process.
 10. SIS work with appropriate intermediaries, including government-funded social enterprise support organisations and referral agencies such as First Port, to increase awareness of the availability of SIS investment finance.
 11. SIS increases awareness of the financing it can offer through presenting at conferences, and running events and seminars.
 12. SIS continues to emphasise that it can take an innovative and entrepreneurial approach to creating a financial package which is appropriate to each individual social enterprise. Using this approach, it should not, therefore, market a range of financial 'products'.
 13. SIS considers augmenting its existing skills set by adding team members with a background in social enterprise and in venture capital or venture philanthropy. This could either be through recruitment or secondment and the benefit would be to enable SIS to offer a wider variety of financing solutions to social enterprises.
 14. All the stakeholders involved in Equal Social Economy Scotland, and in particular the Access to Finance Thematic Board, consider continuing the Development Partnership; and other organisations offering finance or grant funding to the social economy sector are invited to join any new development partnership. This allows the opportunity to coordinate finance packages and discuss complementary rather than competing finance packages.
 15. Funding be identified either to enable SIS to work with social enterprise business support providers to ensure that they are fully conversant with SIS requirements for social enterprise business plans, or to establish a separate pre-investment support section able to offer specialist advice and support to social enterprises in preparing business and financial plans.
 16. Funding be provided to ensure that high-quality post-investment support is available to investee social ventures at a level which reflects the need of the venture and the risk run by SIS. This support should be provided either by a specialist support provider or by high quality volunteer mentors, or by private sector professionals. Where appropriate, mentors should be Board Members of investee ventures.

2 INTRODUCTION

This report is the output of an evaluation undertaken by Blue Horizons (Scotland) Ltd during November 2007.

The purpose of the evaluation was to assess the effectiveness of the Investment Capital for Social Ventures pilot undertaken by Social Investment Scotland (SIS) in identifying social ventures for investment and establishing funding solutions.¹ The pilot had the following aims:

- Assisting the formulation and costing of development plans for each enterprise; and
- Proposing funding solutions that contain elements of investment capital and loan finance.

The objectives of the pilot were to:

- Provide a role model for the sector; and
- Demonstrate in practical terms what is possible in the investment capital area.

The evaluation was required to include:

- An assessment of outcomes from investments that have been concluded²
- Identification of what can be learned from social ventures that did not result in investment
- Identification of strengths and weaknesses of the pilot overall in seeking to achieve its objectives, and
- Recommendations for future delivery of investment to social ventures.

The authors of this report took the view that the pilot's effectiveness could only be assessed and future recommendations made, with a full understanding of the policy context, and so this report starts by outlining it. This report describes the context within which the pilot took place and the process used to evaluate it. It then notes the methodology, gives the research findings and reaches conclusions and recommendations.

It should be noted that this evaluation was undertaken less than 18 months after the pilot commenced. It could not be delayed, because it had to be completed before the EQUAL theme under which it was funded finished at the end of December 2007. Because the pilot had not been operating very long, it was not possible to assess long-term impacts (as opposed to shorter term outputs), by examining the operations of investee ventures. Despite this, the authors believe the experience of working with prospective investee ventures during the pilot itself has produced valuable learning, reflected in the conclusions and recommendations.

¹ A review of SIS itself was completed in September 2007 (McGregor, A., Clark, S., and A. McTier, (2007) *Review Of Social Investment Scotland*, Training And Employment Research Unit Simon Clark Associates Ltd.).

² Those organisations whose applications are being processed were also contacted.

3 THE CONTEXT

A full understanding of the level of achievement of the SIS pilot requires an understanding of the context within which it operates, and so this section provides it. It looks first at the background to the pilot, and then at the funding, financing and business support environment for social enterprises in Scotland. The pilot is also likely to inform future decision-making, so this section also looks at the policy environment, including recent announcements.

3.1 Background to the pilot

The pilot was initiated by Social Economy Scotland³ to address the financing of social ventures, following the recommendations of SIS's report *Investment capital for social ventures*⁴, (hereafter called "the social investment report"). That report defined social ventures, as covering a range which included charities with a mix of trading and grant income at one end and socially-driven businesses at the other.⁵ The report concluded that it was difficult to define the size of the social venture sector in Scotland, although a working figure of around 1000 was mentioned.

The pilot reflected a view that there might be a need for finance for such businesses which could not be provided by commercial banks, pure equity investment or, indeed, the existing loan products offered by SIS. One type of finance identified was "equity-like", that is where an investor shared in the potential success of the venture, and provided expertise, but at a lower than normal financial return in exchange for a social return. The demand for this among existing ventures was thought to be very low, but there might be greater demand among new ventures, particularly community owned renewable energy companies, which might produce substantial financial returns.

The other type of investment was patient capital. This is a partially recoverable loan (or occasionally long-term low yield investment without a set exit strategy) with a variable, but below market, return. Return could be negative, if part of the loan was not recovered, but left as, effectively, a grant. The justification for such an arrangement would be that a social return would be achieved (p.18). The demand for patient capital was hard to assess, but that the sectors most likely to need it included recycling, renewable energy, healthcare, childcare and residential care.

Social Economy Scotland initiated the pilot to test this approach to financing small and medium sized social economy organisations.

³ Social Economy Scotland is a twelve-member Development Partnership, comprising members of public and social economy support sectors and supported under the Theme D of the EQUAL Scotland Programme. EQUAL is a European-funded programme designed to test and promote new ways of combating discrimination and inequalities in the labour market through partnership (and transnational cooperation). Theme D aims to do this by strengthening the social economy. A full description of these entities forms Appendix 1.

⁴ SIS, 2006

[www.socialinvestmentscotland.com/documents/Investment%20Capital%20for%20Social%20Ventures%20Report%20\(Master\)%20\(6-06\).pdf](http://www.socialinvestmentscotland.com/documents/Investment%20Capital%20for%20Social%20Ventures%20Report%20(Master)%20(6-06).pdf)

⁵ As distinct from, but including, social enterprises identified by the former Department of Trade and Industry (now The Department of Business Enterprise and Regulatory Reform) definition, The latter defined social enterprises as, broadly, businesses which exist to fulfil a social purpose, and whose profits were used to further that purpose, or reinvested in the business, rather than being distributed to shareholders.

The social investment report discussed a number of issues which will be examined in this evaluation, including:

1. Uncertainty as to the level of investment-readiness of prospective investee ventures. Broad investment readiness was taken to be demonstrated by a unified, focused management team and robust business plan which are certainly essentials for any business seeking to access commercial finance.
2. Access to grants. The report reflected the view that easy access to grants reduced the demand for finance in any form.
3. The need for, and measurement of, social return on investment.
4. The need for pre-and post-loan or investment support and the form that it should take.

3.2 The environment: funding, financing and business support for social enterprises in Scotland

The pilot was designed to test forms of risk capital delivery not available from existing sources. It is important, therefore, to be aware of what is available elsewhere. Apart from commercial finance, funding and finance is available to social enterprises from various sources in Scotland as described below:⁶

Community development finance institutions

Community development finance institutions (CDFIs) offer loan finance where ventures cannot get a loan from banks. They also help social enterprises prepare business plans. There are five CDFIs in Scotland:

- Developing Strathclyde offer loans from £1,000 to £50,000 to businesses in Lanarkshire, Glasgow, Ayrshire, Renfrewshire and Dunbartonshire who might have limited security.
- Invertag Social Investment Fund, of which SIS is a member, which covers Angus, Dundee, Perth & Kinross and north Fife.
- Highland Opportunity offer loans from £1,000 to £250,000 and cover the Scottish Highlands.
- Social Economy Enterprise Development (SEED) offer loans between £2,500 and £50,000 and cover Edinburgh, Fife, Forth Valley and Lothian.
- Social Investment North East (SINE) offer loans up to £50,000 in Aberdeen/Aberdeenshire.

The five regionally based community development finance institutions (CDFIs) across Scotland had made loans worth more than £1.2 million to March 2007.

Futurebuilders Scotland

This £18 million grant fund was launched in 2003. It was designed to support greater social economy participation in public service delivery and focus on areas of both urban and rural disadvantage⁷. It made investments across five strands; Investment (£12 million, 70% as

⁶ Space precludes a full review of alternative sources of loan and patient capital. Others that can be Accessed in Scotland include Venturesome (<http://www.cafonline.org/default.aspx?page=6903>) and Charity Bank (<http://www.charitybank.org/2006/borrowing-and-advice/just-credit/affordable.html>).

⁷ Ekos Limited (August 2007) Evaluation of the Futurebuilders Scotland Funding Programme (Draft Report)

capital investment), Seedcorn (£4 million), Future Entrepreneurs (£0.4 million), Learning (£1 million) and Support (£1 million).

The fund was operating during the first nine months of the SIS pilot and provided an alternative route to finance (in the form of a grant rather than a loan) for eligible ventures, though it was heavily oversubscribed. Futurebuilders did, however, aim to increase the propensity of its users to borrow⁸ and it levered £12.6 million from lenders to enterprises; most of which had never borrowed before.

The draft evaluation of the programme made recommendations for any successor, including:

- The Government should consider all alternative investment methods and “as a point of principle grant subsidy should be used only where no other form of finance (earned, borrowed or self-generated income) can be more (or as) effectively used to meet objectives. In practice, this means making use of loans, equity-like investments, patient capital, or underwriting agreements as a part of the funding mix (either provided directly through a successor funding programme or in conjunction with an appropriate delivery partner). Grants might be used to good effect to build investment readiness (as has been the case with Futurebuilders Scotland) while various types of lending offer longer-term financing options”(p.71). This can increase leverage for public funds.
- A clearer and more logical base should be used for targeting resources. Futurebuilders focused on projects that helped to meet defined Closing the Opportunity Gap objectives. This excluded many social economy organisations. There may be a case for supporting social economy development as an end in itself, not just as a means to a prescribed end.
- Resources should be allocated for training, technical and business support to directly back up investments and ensure their success.⁹
- A future fund should be delivered by intermediaries rather than directly by government (p.72).

Futurebuilders Scotland was being evaluated as this report was completed. Its draft conclusions note that any future public investment might be concentrated on asset development, public sector delivery and early stage social enterprise development.¹⁰ These points are likely to be taken into account in targeting the Scottish Investment Fund (see below).

Big Lottery

The Big Lottery has several programmes for which social enterprises might apply. The most significant of these is Investing in Communities. This has strands covering asset acquisition, community-building, life transitions and helping people cope with new patterns of life. All of these might be of interest to social ventures in different sectors. Their use may reduce or increase the appetite for investment.

For example, the first allows social enterprises to apply for up to £1 million to acquire or develop assets for community use. Other purposes include: building stronger more vibrant communities; helping people deal with change in their lives and encouraging them to move

⁸ Ekos Limited (August 2007) Evaluation of the Futurebuilders Scotland Funding Programme (Draft Report) p.52

⁹ Social Economy Scotland Policy Briefing, November 2007.

¹⁰ Ibid. p.67-8

on, and enabling people to cope with new patterns of life and the pace of change communities are experiencing.¹¹

This funding stream has the potential to increase investment if a grant is provided as part of a financing package which includes a patient capital investment, and which could not otherwise be offered. On the other hand, it could reduce the appetite for social enterprises to take on investment, if they can obtain a grant instead of a loan.

Another Big Lottery funding stream, Investing in Ideas, could, in certain circumstances, pay for market research or a feasibility study for a social venture. In this way it could help it prepare a business plan used to apply for investment capital finance.

The Henry Duncan Initiative

This is Lloyds TSB Foundation's new venture philanthropy initiative for Scotland. Its aim will be to tackle poverty and disadvantage head-on by:

- Applying the principles of investment / venture capital in a philanthropic arena.
- Engaging a range of investors to include loans, equity and donated funds to drive social change.
- Making and managing a strategic multi-million pound investment in voluntary organisations over 5-10 year periods.
- Focusing on practical delivery designed to make a significant difference in lives of people across Scotland.
- Measuring the impact and reporting outcomes to investors leading to increasingly effective use of resources.¹²

The initiative will first undertake research, followed by consultation, and so it will be some time before it makes finance available. When it does so, it will be in line with a number of programmes designed in the earlier stages.¹³

Social Ventures Scotland

Social Ventures Scotland is a proposed initiative described as Scotland's first venture philanthropy¹⁴ organisation, and has been established by CEIS¹⁵, Forth Sector and Senscot¹⁶. It has been designed to "bridge the demand for sustainable investment in social enterprises with the willingness of investors to invest in organisations that will deliver significant social outcomes in a sustainable way"¹⁷ It has, therefore, the potential to

¹¹ www.biglotteryfund.org.uk/prog_investing-in-communities?regioncode=-sco&progStatus=open&country=%20%20Scotland&status=theProg&chan=funding&title=Investing%20In%20Communities

¹² Rodgers Ray & Berndtson (2007) Candidate *Brief for the Position of Head of Venture Philanthropy with Lloyds TSB Foundation* p 4

¹³ Space precludes a review of other venture philanthropy initiatives, such as Impetus Trust (www.impetus.org.uk/) and New Philanthropy Capital (www.philanthropycapital.org/).

¹⁴ Venture philanthropy is the use of capital provided by philanthropic foundations and individuals to assist businesses with a social purpose to achieve that purpose, while furnishing the investor with a combined financial and social return. A core element of it is provision of mentoring or other involvement by the philanthropist. Financial self sufficiency on the part of the social enterprise is taken as an acceptable exit strategy.

¹⁵ www.ceis.org.uk

¹⁶ Senscot is an independent network aiming to social capital through spreading social enterprise, particularly by supporting social entrepreneurs (www.senscot.net/index.php?W21ID=85).

¹⁷ www.ceis.org.uk/funding_finance/social_ventures.html

operate in the same market as SIS. It is not clear, however whether it will proceed, and if it did so, if it would need to compete for investment funds and possibly for a market, with the Henry Duncan Initiative, described above.

Social Enterprise Business Support

This is relevant because social enterprises require pre-investment support before they can access patient capital or another form of innovative financing. Such support must either be offered by SIS, or by a partner organisation with the requisite level of skill.

The national contract for business development support will expire at the end of 2008. Specialist social enterprise business support has, historically, been offered separately, and by several agencies. The contract for Lowland Scotland is currently out to tender and will be won by one of a number of consortia. The contract for support in the Highlands and Islands is held by Hisez, a Community Interest Company which provides bespoke and integrated business support for social enterprises across Highlands & Islands.

There are other providers, some of them with a significant level of social enterprise support activity. They include CEiS¹⁸, Forth Sector¹⁹ and CEL.²⁰

3.3 The future: policies and funding for social enterprise support

The purpose of this evaluation is to inform future work, and so it has been prepared with the following policy context and plans in mind.

The Social Enterprise Strategy²¹

This strategy, which has been adopted by the new government, places great importance on the provision of finance to social enterprises, making it the third of its four aims.²² The oversubscription of available loan funds to date is taken by the strategy to be evidence of the market need.²³ The strategy notes that banks are increasingly lending to social enterprises, but sees SIS and the Community Development Finance Institutions as important where they do not. It says that the government will look at “at a range of potential financial solutions, such as meeting the gap between grants and commercial loans, testing out so called ‘patient capital’ models and considering the potential of further public support through programmes such as Futurebuilders Scotland and Wider Role.”(p.2)

In view of the current animated discussion about the role of grant funding in social enterprise start-up and service delivery (which is also reflected in the feedback and conclusions of this report) it is worth noting that the strategy sees a possible role for grants in helping develop assets (p.29).

¹⁸ <http://www.ceis.org.uk/>

¹⁹ www.forthsector.org.uk/

²⁰ <http://www.communityenterprise.co.uk/>

²¹ *Better business: A strategy and action plan for social enterprise in Scotland*, Scottish Government, 2007

²² The strategy refers to a new organisation, First Port, which been established to provide a point of entry and signposting to pre-start up social enterprises, and more particularly aspiring social entrepreneurs, and networking body, Senscot, which establishes local or specialist networks for peer support. Any roll-out from the SIS pilot will need to use these as points of entry for its service.

²³ It notes that SIS approved more than £5 million in loans to social economy organisations since 2002 (including Futurebuilders Plus loans).

The strategy also recognises a need to help board members and senior managers of social enterprises understand financial issues. This view is supported by the conclusions and recommendations²⁴ reached in this evaluation

The Economic Strategy for Scotland

The Economic Strategy for Scotland was launched on 11 November 2007. It describes the government's purpose as increasing sustainable economic growth, with opportunities for all, by addressing five economic objectives. These are to make Scotland: greener; safer and stronger; wealthier and fairer; healthier and smarter. It emphasises that the public, private and third sectors must work collaboratively to achieve these purposes.²⁵

The strategy outlines five Strategic Priorities that are needed to attain those objectives, two of which are a Supportive Business Environment and Equity. With regard to the former, it is stated that the third sector has a role in creating a supportive business environment and that investment is critical to the development of that environment. It states that it will "address gaps in access to capital that are constraining Scottish businesses from reaching their full potential, whilst helping to build capacity in the investment community to remove barriers to investment."²⁶

The Strategy also emphasises that it will focus on key sectors, including those which are not yet established as having comparative advantage. It mentions, in particular: creative industries (including digital content and technologies); energy (with a particular focus on renewables); financial and business services; food and drink (including agriculture & fisheries); life sciences (including biotechnology and translational medicine); tourism and education and healthcare.²⁷ A report on the potential within key sectors is due to be published before the end of 2007.²⁸

Help to those sectors will reflect the extent to which, among other things, "government intervention can make a significant difference to future success by facilitating or accelerating development in areas where the market alone cannot deliver the best outcome."²⁹ Government is, therefore, prepared to direct resources to businesses, where its support can make them considerably more successful than would otherwise be the case.

In relation to equity, the third sector's role is also emphasised. The government says that it will "support social enterprise, as part of investment in an enterprising third sector, ensuring the provision of start-up assistance and encouraging efforts to provide supported employment as an early step for those furthest from the labour market".³⁰

Taken together, these statements suggest that directing social investment through a third sector business support organisation to social enterprises in specified key sectors, leading to greater success of those enterprises than would otherwise be the case, is compatible with the government's approach. Such an approach would help the government achieve its stated purpose. However it should be noted that Government is only likely to provide the necessary support if the investment is likely to make a significant and measureable

²⁴ A training programme has been commissioned, to be completed by the end of March 2008.

²⁵ p.2

²⁶ p.28

²⁷ p.29

²⁸ Stuart McKay, Third Sector Team, Scottish Government, Personal communication, November 2007

²⁹ p.27

³⁰ p.38

contribution to its strategic targets which, in the short term, are to increase GDP growth to the UK level, and reduce emissions, both by 2011.³¹

Scottish Budget and Spending Review 2007

This review, issued on 13th November 2007, announced a £63 million development programme, designed to create a more enterprising third sector, and a £30 million Scottish Investment Fund to encourage greater investment in assets, business development and the skills of those working in the third sector.³² The priorities for these will be:

- Strategic Links to Community Planning and Outcome Agreements
- Commissioning and Procurement
- Early Start Up
- Intelligent Financing (potentially of the type tested in the investment pilot; also possible use of three- year funding agreements)
- Scottish Investment Fund (£30m)
- Research and Development Programme
- Improved Business Processes
- Skills, Learning and Leadership.³³

Part of the investment fund could potentially be administered by SIS and could be used for patient capital and other investment products.

³¹ p. 48. Longer term targets relate to increasing GDP, productivity, employment, healthy life expectancy, income and the incomes of poorer people, as well as narrowing the employment gap between Scottish regions, and matching European population growth, all by 2017, and reducing emissions by 80% by 2050.

³² <http://www.scotland.gov.uk/News/This-Week/Speeches/spendreview07>

³³ Stuart McKay, Social Enterprise Manager, Scottish Government, Face to Face Interview, 15th November 2007

4 METHODOLOGY

The evaluation team undertook the following activities in order to fulfil the evaluation brief:

1. Desk Research

This identified the current activities and issues in social economy and social enterprise financing in Scotland which are outlined in the section 2. It included a review of, among others:

- *Investment capital for social ventures*,
- The Scottish Government's Social Enterprise Strategy,
- The Economic Strategy for Scotland,
- The Scottish Budget and Spending Review issued in November 2007, and
- The latest Funders Forum work plan.³⁴

2. Face to Face and Telephone Interviews:

- With the social ventures named in the Investment capital report and others who had discussions with SIS during the pilot. These interviews identified how the ventures became involved with the pilot, their views of that experience and the reasons why they did or did not take SIS investment.
- With a cross section of other stakeholders. These interviews explored stakeholders' expectations from the pilot, their views of its implementation and how financing for Scottish social ventures should develop.

3. Workshop and discussions with SIS team:

The workshop helped to establish the skills available within SIS with which to implement the pilot, identified the areas which SIS felt had been most successful, and which less so, and discussed the research undertaken and issues identified in the interviews. It also considered how learning from the pilot could be used to inform future support to social investment activity.

4. Draft Report Presentation:

- Feedback obtained from SIS was taken into account in preparing the final report.

5. Submission of Final Report:

- The final report was submitted to SIS and distributed to key stakeholders.

³⁴ *Workplan 2007*, Scotland Funders Forum 2007

5 RESEARCH RESULTS

This section of the report summarises the information gained from the desk research and the interviews with social ventures, stakeholders and SIS.

5.1 Key points from desk research

The desk research focused on three issues:

- The likely future policy context and social enterprise financing environment within which this evaluation would be read.
- The current position regarding measuring social return on investment.
- Other examples of social financing. It was important to see whether other organisations have offered social financing with different characteristics from that offered by SIS, or whether such financing (whether by investment or loan) had any features which could or should have been tried by SIS or could be tested by them in future.

These issues are considered in turn below.

Future policy context and social enterprise financing environment

The future policy and social enterprise financing context is laid out in section 2 above. The trends can be summarised as follows:

- There is a clear intention on the part of the Scottish government to support social investment in the future. Its £30 million investment fund will be primarily used for financing with the expectation of a financial return, but may encompass some targeted grant funding.
- There will be an opportunity for SIS to be considered as a delivery vehicle for all or part of this fund.
- Big Lottery and charitable foundation grants will continue to be available. There is an opportunity, through the Scotland Funders Forum, to influence how and for what purposes this is offered. The Forum is currently looking at ways of increasing partnership activity for funding and ways of diversifying³⁵ with a view to reducing the dependency culture within parts of the social economy and increasing the opportunity for grants to become part of financing 'packages'. There is also a trend towards using grants where they are the only, or clearly most appropriate, option.³⁶

Measuring social return on investment (SROI)

This is important because measurable social return provides the justification for investment at below market rates, or where there is a higher level of risk than would normally be justified. The balanced scorecard was identified in the social investment report as a comparatively straightforward way of measuring social return. That report noted, however, that a considerable amount of work is being undertaken to identifying more sophisticated measures. Some of that work is still in progress. Two publications are however worth noting:

³⁵ 'Workplan 2007', Scotland Funders Forum 2007

³⁶ Ekos Limited (August 2007) Evaluation of the Futurebuilders Scotland Funding Programme (Draft Report) p.59

- The new economics foundation (nef) has published a report³⁷ on SROI which notes the value of using the approach in respect of certain social enterprises. These include Intermediate Labour Market and employment-related initiatives, but “further research is required before it can be used in a wider range of sectors” (p.23).
- The report confirms that SROI can now be used by investors to put the social and financial value of their investments into perspective. It also notes that SROI is a particularly useful way of illustrating the economic value of the social and environmental impacts of organisations that may otherwise not appear viable as they do not generate financial returns because they require subsidy. Nef is seeking interest from organisations in joining a network to develop a set of tools for measuring and testing social return on investment. SIS might wish to take up this offer.
- Haldane Associates have undertaken some work³⁸ on the nature of SROI and how to measure it as part of the Equal project.
- Forth Sector have been commissioned by The Scottish Government’s Social Enterprise Unit to develop a predictive model for capturing social return on investment. SIS retains an interest in the development of a predictive SROI model that is both manageable and effective in the sense of being low impact on the organisations being assessed. For the purposes of the pilot and the current absence of these indicators, SIS has utilised the balanced scorecard application.

Other examples of social financing

Most of these are discussed above, in section 2.2. There remains Futurebuilders England, which is not part of the direct environment for SIS, but is still of interest, principally because of its use of grants.

Futurebuilders England

Futurebuilders England is an experimental fund whose aims include testing new ways of funding the third sector to support long-term sustainability³⁹. It is therefore interested in the same issues as SIS. Futurebuilders England’s use of grants and of a sliding scale of support from grants to loans are worth examining. It does not, however, offer shared risk investment in the way that SIS does.

Futurebuilders England offers the following grants:

- Time limited revenue funding (up to a maximum of two years) to cover start-up costs, staff costs or other transitional costs incurred before contract or fee income becomes available.
- Capital funding to meet all or part of the costs of buildings, vehicles or equipment where loan finance would be premature because contract or fee income is not yet in place to support the loan.
- Capacity building to provide practical support, for example to develop marketing and negotiation skills, IT systems or project management capabilities.⁴⁰

³⁷ Boyle, D & Murphy, M (ed.s) (2007) *Social Return on Investment: A Valuing What Matters: The Findings And Recommendations From A Pilot Study* new economics foundation

³⁸ S. Durie (2007) *Mental Health And Social Enterprise Solutions: A On A Compelling Case For Cost Savings In The Long Term Care: Interim Results From social firms’ Social Return On Investment Analyses in Scotland* Haldane Associates/Forth Sector

www.socialfirms.co.uk/document/format_uploaded/download.php/doc563.html

³⁹ www.futurebuilders-england.org.uk/content/QuestionsandAnswers1/article_37_28.aspx?iid=78

⁴⁰ www.futurebuilders-england.org.uk/content/Funding/GrantFunding.aspx

- Development Grants. These are offered to small or medium sized organisations that demonstrate real potential and an interesting approach (to public service delivery) but require pre-investment support. The maximum grant is around £10,000 and recipients are expected to continue with the application after spending the grant.⁴¹ These grants were alluded to in the social investment report (p.19).

Futurebuilders financing packages can be described as using a sliding scale. For start-up businesses the offer may be weighted towards grant funding. As businesses grow and develop the ability to repay, the grant element falls.

5.2 Feedback from interviews with social ventures: funding solutions proposed and outcomes

All social ventures which took part in the pilot⁴² and which still existed, were contacted, and interviews were conducted with all but one of them.⁴³ This section summarises the feedback from those interviews and then provides a table listing the ventures with a description of their activity, the funding solution proposed by SIS and the outcome.

In summary as at mid November 2007 of the 15 social ventures who had contact with SIS through the pilot:

- 2 had secured SIS pilot funding packages.
- 2 had formal SIS pilot funding packages offers currently under consideration.
- 1 had an offer of SIS pilot funding, which could be progressed once a planning issue has been resolved.
- 2 had reached the offer stage, but decided not to proceed. In one case this was because the decision was made not to proceed with the venture itself. In the other, the business was able to access the capital it needed from a combination of mainstream bank and grant sources, partly because of the development work they had undertaken with SIS.
- 4 succeeded in acquiring the funds they needed elsewhere before reaching an offer stage.
- 1 went into liquidation early in 2007.
- 1 did not proceed after receiving initial feedback from SIS on its proposed ventures.

The following summarises the key points from the interviews:

- There were variable levels of awareness of the availability of different kinds of finance amongst the social enterprises at their point of entry into the pilot.
- The type of financial package required varied by client and other funders were almost always involved.
- SIS often worked to secure financing from other lenders as part of a package. In two out of the twelve enterprises interviewed, other commercial lenders made finance available as a result of SIS involvement.

⁴¹ <http://futurebuilders2006.mandogroup.com/content/Funding/DevelopmentGrants.aspx>

⁴² One enterprise Oneplus, had gone into liquidation, though some information regarding it is included in the table later in this section.

⁴³ In that instance the enterprise was able to make only basic comments, because the relevant member of staff had left.

- One venture stated that other alternative finance providers had been unable to offer them the scale of financing they needed and that the finance they had obtained from SIS had enabled them to remain in business. It was also stated that they would now be able to increase turnover and profit rapidly.
- Some of the enterprises felt able to produce high quality business plans to investment-ready standard themselves, or with the help of their accountants and other advisors. More felt they needed assistance with this. In both cases, business plans needed development, and this extended the time it took to become investment-ready.
- Roughly half the interviewees were happy with the process, timescales and guidelines involved in working with SIS. The other half raised some issues regarding the speed of response, or the nature of queries, and in one case delays had caused an enterprise to move further into debt than they had expected. They said that it would have helped to have been aware, at the start of the process, of the time that it would take to reach a decision. It appeared that social ventures involved later in the pilot were more satisfied than earlier participants. This suggested that SIS have learned from their early experience.
- Nearly all of the ventures interviewed were aiming to become completely self sustaining. Most believed that grant funding was a useful way of initiating new ventures, because it carried lower financial risk and cost than financing, which was important at start-up. It eased cash-flow issues and allowed a track record and income to be developed. They felt that once this had been accomplished, ventures should seek loan and patient capital funding solutions which would allow their venture to become sustainable.
- Some interviewees felt that grants should be made available over the long-term for voluntary providers of essential support services that could not generate significant income.
- The ventures interviewed were all aware of the need to identify social return and measure it, but most needed help with finding appropriate measures.
- Almost all of the ventures interviewed were happy with the support and service they had received from SIS. Those which would have liked more clarity at the outset, and faster progress, nevertheless expressed satisfaction with the support they had received from SIS. One venture registered dissatisfaction and this related to lack of clarity.

Table 1 provides a summary of the organisations involved in the pilot who had obtained financing⁴⁴ as at mid November 2007.

Table 2 describes those which are still in process or who did not proceed.

⁴⁴ Please note that only finance secured outcomes are possible to measure at this stage.

Table 1: SIS Pilot: Participating Ventures, Proposals and Outcomes

Organisation	Description	Funding Solutions Proposed	Outcome
Company A	A new social enterprise created to produce, bottle and wholesale Shetland Spring Water from the islands own supply. Bottled water currently 100% 'imported'.	<p>£80K gap post grant and loan funding secured from other sources.</p> <p>£60K SIS loan + £20K patient capital from pilot linked to agreed SROIs proposed.</p>	<p>£80K funding package secured from SIS August 2007. Terms:</p> <ul style="list-style-type: none"> • 10% interest p.a. rolled up for first 3 years and capitalised. • New capital balance repayable over 4 years but capped at £20,000 on achievement of agreed SROI. • No penalty for early repayment in minimum £5000 sums after 3 years. • 1% arrangement fee, max. £1000 legal fees. • Secured by bond and floating charge over assets.
Company B	<p>Recycling of 'white goods' using trainees, leading to training and employment outcomes and sale of recycled goods for social benefit. Proposal was to support:</p> <ul style="list-style-type: none"> • Expansion to 3 shops • Move from self-financing (from grant to loan) • Attain remaining technical standards 	£120K - £70K SIS revolving loan and + £50K patient capital from pilot linked to agreed SROIs.	<p>Package agreed and delivered Patient capital loan terms:</p> <ul style="list-style-type: none"> • Repayments of capital and interest at 1.5% of gross income, payable quarterly in arrears. • Repayment cap at £75,000 at SIS. discretion if social outcomes achieved. • Arrangement fee £500. • Legal fees up to £1,000. • No repayment for first 3 years, at discretion of SIS. • Monthly confirmation of 150% asset cover. • EDITD: interest ratio of 2:1 • Specified balanced scorecard outcomes. • SIS loans to take priority over existing directors' loans.

Table 2: SIS Pilot: Participating Ventures Still in Process or Not Proceeding

Org. No.	Description	Funding Solutions Proposed	Outcome
1	<p>Proposed joint venture between two Christian social enterprises with charitable aims.</p> <p>To provide estate cleaning services for Registered Social Landlords whilst creating supported training and employment opportunities for disadvantaged people.</p>	<p>After a period of working on aligning business plan with SIS needs, SIS finance offered, subject to satisfactory projections, in the form of £25,000 non-recourse loan and up to £80,000 revolving credit facility, over 5 years. The former was to be repayable only if agreed levels of income generated, in a single payment at the end of the term, and would be reduced if social outcome achieved.</p>	<p>Idea put on hold because:</p> <ul style="list-style-type: none"> • Housing Associations decided to move to competitive tendering, removing the guaranteed market. • Parent organisations had other opportunities with lower risk. • Development process slow. <p>Applicants thanked SIS for assistance which would improve quality of their future proposals.</p>
2	<p>Originally looking at reconditioning computers, but hardware costs have fallen making this uneconomic. Now looking at reconditioning white goods.</p>	<p>£100K of funding is being sought from SIS. Likely to be £80K SIS loan + £20K patient capital linked to SROIs.</p> <p>Currently involved in intensive property search as very specific property requirements and figures cannot be finalised until property details concluded.</p>	<p>Offer in principle from SIS is imminent. Will need to see revised plan showing new premises before confirmation.</p>
3	<p>One of Scotland's largest charities and a leading provider of services for adults and children with learning disabilities.</p> <p>The organisation operates 147 residential sites, employs in excess of 1,300 people and turns over more than £26m.</p>	<p>Spoke to SIS about the pilot but finance not required as proposals were bankable because they could be secured on property.</p>	<p>Finance obtained elsewhere.</p>

Org. No.	Description	Funding Solutions Proposed	Outcome
4	To promote rural regeneration within its community, primarily through ethical investments. The main projects are local; a crafts and wholefoods shop and a community-owned wind farm.	Approached SIS due to information given at a conference. Loan funding / patient capital being sought for 2 ventures. Amount required not clear.	One project deemed bankable and the other would not generate sufficient income to repay borrowings, so did not proceed with SIS. Would have liked more clarity.
5	Social enterprise providing a range of services to young people 'at risk'. Services include residential care, special secondary education, social welfare, community outreach and youth employment enterprise activities.	Registered an interest in the SIS pilot and early discussions regarding large scale requirement - £7m project. Long established company with good banking relationship. Subsequent grant funding and commercial funding secured and no need for SIS funding.	Funding secured via grant and commercial finance.
6	To provide recreational, personal and social development opportunities for young people through gymnastics. Gymnastic classes are also provided for people with disabilities.	Business is 100% self financing and clear that expansion funding requirement loan / patient capital based. Total expansion project was in region of £300K – £350K of which gap funding of £50K sought. In discussions with SIS and SIS willing to make an offer.	Cannot proceed until difficulties with the building required are resolved – these are Council and planning related issues. SIS offer of potential support remains.
7	Development of environmentally and economically sustainable projects and businesses and to alleviate poverty and disadvantage. Helps businesses to recycle, reduce costs	CEO heard about SIS finance at a conference. Parent charity previously effectively 'banking' the social venture but the needed the latter to source own finance. Also recognised need for self sufficiency and business at stage and scale where this is now viable.	Offer from SIS up for approval with board.

Org. No.	Description	Funding Solutions Proposed	Outcome
	and become more environmentally friendly. Subsidiary of larger charity.	SIS input has influenced bank and now looking at a package of 2 year term loan from bank and SIS funding. Have found SIS very easy to work with.	
8	Offering new opportunities to families across Scotland; Organisation provided information, training and employment opportunities. It was also a major provider of day-care, out of school care and care services while contributing to the regeneration of disadvantaged communities.	Historical relationship with SIS.	Considerable delay in obtaining financial projections, and when received they showed a £2.5 million overdraft (bank had partial security from mortgage). Scale of operations (£12m. p.a.) exceeded management capacity of staff. Faced serious and increasing liquidity problems. Organisation went into liquidation at the beginning of 2007.
9	To provide support for adult and young carers, adults with mental health issues, the voluntary sector and volunteers, shopmobility and direct payments.	<p>Did not approach with a view to really seeking financial support, more out of interest and respect for SIS. Support they offered was very helpful.</p> <p>Believe longer term reliance on grant funding has many risks for the sector and the loan / patient capital packages created via SIS and the pilot are what's needed for trading social ventures sustainable funding requirements.</p>	No finance required.
10	Providing work experience, training and employment to individuals with learning difficulties through the production of organic compost, bark and a range of horticulture products.	<p>Approached SIS about loan funding as a result of a trade fair.</p> <p>Funding sought to meet a funding gap of £100K - £150K post securing other funding, including a grant from Future Builders.</p> <p>Were very happy with progress with SIS and their understanding of the venture's needs,</p>	<p>Offer would have been made but client didn't need SIS funding as Futurebuilders made a subsequent award and bank were able to back lesser requirement.</p> <p>Would return to SIS for future support.</p>

Org. No.	Description	Funding Solutions Proposed	Outcome
		but a subsequent award from Futurebuilders reduced need for bank funding.	
11	<p>Established in late 1980s to offer people with a range of learning disabilities a training provision that would successfully address key areas towards helping them make the successful transition into the world of paid work.</p> <p>The venture operates a bakery, food processing unit, outside catering and conference facilities.</p>	<p>A meeting was organised with SIS which was helpful in looking at the enterprise's future financing as the operation moves towards lowering grant income and increasing self sustainability. It is intended that at least 80% self sustainability will be achieved over 5 years.</p> <p>Didn't need SIS funding ultimately as using grant funding meantime to allow breathing pace to build level of income generated.</p> <p>Would consider returning to SIS at a later stage if funding needed.</p>	Finance not required from SIS as secured via grant funding.
12	Working exclusively with young people and children to address the issues of: childhood obesity, promoting physical activity, anti-social behaviour, social exclusion and territorialism. Works with ages 2- 20+, initially with play using a mascot as fun role model, moving into sport, particularly weight-lifting, athletics and football, at various levels including elite. Now developing a joint venture for a large-scale development, in partnership with a regeneration agency. 38 employees (full and part-time).	Registered an interest in SIS funding following successful Futurebuilders application and SIS willing to look at a funding package.	<p>Application on hold pending outcome of negotiations with joint venture partner, planning permission application and grant funding applications.</p> <p>Manager holds strong belief that government should fund his work, in return for its socio-economic benefits. Currently receives £51,000 from a local authority funder. Aiming for 90% self-financing by 2008.</p>

5.3 Feedback from interviews with stakeholders and discussions with SIS

The authors talked to people from several organisations with an interest in the pilot including:

- The Scottish Council for Voluntary Organisations, lead partner in the EQUAL Social Economy Scotland Development Partnership.
- Partners in the Social Economy Scotland Development Partnership funded under Theme D (Entrepreneurship) of the Equal programme.
- Members of the EQUAL Access to Finance Thematic Board which was established to oversee the implementation of the Social Equity pilot.
- Scottish Government Third Sector Division, Social Enterprise Team.

This section details the feedback received, and comments on the issues raised by it.

Almost all interviewees complimented SIS on the taking the pilot forward, and on the high level of professionalism and commitment shown by its staff. It was noted that they had worked hard to develop financing solutions other than traditional loans. One interviewee commented they had achieved exceptional levels of client satisfaction, a point confirmed in SIS's recent review.⁴⁵

Some interviewees felt that the pilot would have been more effective if there had been a greater level of communication between SIS and members of Social Economy Scotland at the start, so that all stakeholders shared an expectation of the pilot's purpose. It does appear that the social investment report is clear on this point (p.24), but this was clearly not fully appreciated by all members of Social Economy Scotland. The need for a more sophisticated kind of finance than was then available was understood but there was less clarity about what that would look like and in particular what "patient capital" was.⁴⁶

It became clear in the interviews that key stakeholders had expected a higher level of risk taking than actually took place. The point was made that the pilot was an opportunity greater innovation, even with its accompanying risk, because this would have led to greater learning. It is true that of the fifteen ventures which SIS had worked with, only two had drawn down loans. This might suggest a lack of innovation in finding financing solutions which fitted the needs of each venture. On the other hand both the two loans drawn down, and another offered, demonstrated between them:

- Interest roll-up and capitalisation.
- A repayment cap effectively making a loan interest free over its full seven year term if social return milestones are reached.
- Interest and capital repayments linked to gross income (so explicitly sharing risk).
- Three year interest holiday.
- A fully recoverable loan.

This list appears to include examples of virtually all weapons in the patient capital armoury. It is true that there is no full risk-sharing of the kind usually thought of as "equity-like" but

⁴⁵ 'Review of Social Investment Scotland', Training and Employment Research Unit Simon Clark Associates Limited, September 2007

⁴⁶ Again, this is described in detail in the report (p.18).

none of the applicant organisations appear to have had business plans which offered the level of financial reward needed to justify that kind of investment. In balance, and taking consideration of deals in the pipeline, there is evidence of a significant level of inventiveness being applied. Perhaps interview feedback received indicates a need for SIS to have been more explicit and detailed about its achievements when reporting to Social Economy Scotland.

The focus on learning was one reason why there was limited concern at the low number of investments made. The stated purpose of the pilot was not to place funds but to discover what worked and what did not. It was also noted that SIS achieved a useful intervention when offering pre-investment support to those social enterprises, which thereby developed stronger plans and were able to access finance or a grant elsewhere. One interviewee noted, in particular, that SIS had spent significant time of this kind with 190 enterprises through its mainstream programme many of whom ultimately obtained funding elsewhere. In these cases, even though the funding did not come via SIS, these could be regarded as successful outcomes.

It was also suggested that more partnership working would have led to a higher level of risk-taking. Two interviewees noticed that all the SIS staff had a banking background and they felt that this might have led to a comparatively cautious approach, even regarding non-loan financing. It is certainly true that bankers have a reputation for being risk-averse. Faced with this feedback it is only possible to consider the type of packages actually offered. One of these was a loan to a venture with no fixed assets and whose cash flow forecast projects a £130,000 loss in 2008. This particular case does seem to indicate a willingness to take risk.

The lack of use of grants was also raised. It was suggested that there could have been a greater incentive to stimulate the early demand particularly since the project had been capitalised by finance which could be treated as a grant. One interviewee questioned whether the SIS approach of waiving interest if social impact targets were met some years into a loan was a big enough incentive for social ventures. Different interviewees suggested that a considerably larger level of subsidy from 25 to 50 per cent of the total financing package would have stimulated greater demand.

Other interviewees suggested a more targeted use of grants, similar to the approach taken by Futurebuilders England. One made the point that grants can play a vital role at business start-up by reducing the need for loans, reducing the risk carried by investors and encouraging social enterprises to test a business idea.⁴⁷ Another felt that in the future grants could:

- Help at the start up phase through supporting start up capital and working capital to allow time for building income generation.
- Reduce as self sustainability increases.
- Be linked to SROs.

The role of grants is a central issue in finance for the social enterprise sector. It is considered in detail in the conclusion.

⁴⁷ Divine Chocolate (www.divinechocolate.com) was mentioned as an example of the business started with a £400,000 grant, which has now become a successful social enterprise.

Several interviewees raised the issue of demand and how far it had been identified. It was mostly acknowledged that the pilot had to create its own market and therefore size of the marketplace could not be accurately known in advance. It was suggested, nevertheless, that the pilot had not necessarily provided a true indication of the level of demand for mezzanine or equity-type investment for three reasons. Firstly, the interviewees felt that few social enterprises were aware of the opportunity for investment under the pilot. SIS worked with enterprises which had registered their interest at the time of the social investment research or had heard of the programme by word of mouth. There was a view that had SIS given presentations at several conferences, more social enterprises might have come forward.

Secondly, the interviewees felt that SIS should have been more generous in the terms it offered and this would have led to more uptake. Thirdly, the point was made that accepting some of level of grant as part of the package would have increased uptake. It was acknowledged, however, that the limited uptake could also have reflected a limited level of understanding of social investment among enterprises in the sector.

If the purpose stated in the proposal for the pilot contained in the social investment report represents the actual, then the purpose was not to test demand. Instead, it was to provide role models, and test what is possible in the investment capital area (p.24). SIS certainly takes the view that the intention was always to work with the enterprises which had identified themselves as interested during the research leading to the social investment report. Having said that, they did work with a small number of additional enterprises who approached, or were introduced, to SIS. At least one of those learned about the pilot from SIS at a conference. The point about grants is discussed in the conclusion and whilst there is not consensus that grants should be used as a tool to stimulate demand for finance, it is generally recognised that interest will certainly be raised amongst prospective applicants.

A final issue raised was regarding whether applications could have been processed faster. This echoes a point made by some social ventures. SIS have pointed out that the process of developing a business plan to a standard where it is investment-ready can be much slower than the processes involved in approving a grant and that the former is appropriate due to the level of business plan robustness required where funds are to be repaid. This is also discussed further in the conclusions. SIS have also now introduced and are testing an analytical model and assessment matrix which are being shared with clients and aim to improve process clarity and speed overall progress.

Overall, interviewees said that a greater level of partnership between SIS and others, including other members of the Social Economy Partnership, would have been beneficial. It might have led to more referrals from partnership members and to assessment and decision-making which took into account social enterprise experience as well as that of banking.

It was generally agreed that loan and patient capital funding could play an increasing role, alongside this more targeted use of grants, in building longer term sustainability for income generating enterprises within the sector (as opposed to those not generating income but delivering services with a social benefit that ought to be publicly funded, probably through grants).

6 CONCLUSIONS

This summary examines each of the issues this evaluation was required to address in turn.

6.1 Assessment of pilot aims and objectives

Aims

The pilot had the following aims:

- Assisting the formulation and costing of development plans for each enterprise; and
- Proposing funding solutions that contain elements of investment capital and loan finance.

The first aim reflected the view that social enterprises needed to receive support in order to become investment-ready. This was proved to be accurate. In the case of all of the social enterprises SIS worked with, there was a need to help them improve the quality of their development and business plans before they were ready to receive investment.

The second aim is the core purpose of the pilot, to see whether there were cases where social enterprises needed more than loan capital in order to develop. The evaluation found that there two such investments were made and a further third investment is likely to be made by the end of 2007. Another fourth investment will be made once the venture finds suitable premises and submits an updated business plan which includes the costs of operating from that site. This may be possible during January 2008. A fifth possible investment, a large-scale business, also appears to meet requirements and is in process. Of those two investments concluded, leveraged funding totalling £130,000, has also been lent from SIS's main fund.

While the purpose of the pilot was not to place a particular amount of capital, it is worth noting that so far £70,000 of patient capital investment within total commitments of £200,000 has been placed. Pipeline investment could amount to a further £550,000 for the other three enterprises summarised above.

These investments demonstrate that social ventures in Scotland need access to finance which is: an appropriate mix of grant, equity or quasi-equity; affordable; matches repayments to income, and takes account of social benefit. This project does not, and was not designed to, establish the extent of this demand. It is important that work is done to establish that demand if further public capital is ring-fenced for patient capital or similar risk investment in social ventures.

Objectives

The objectives of the pilot were to:

- Provide a role model for the sector; and
- Demonstrating in practical terms what is possible the investment capital area.

The first objective reflected a view that social enterprises were reliant on traditional forms of financing both from grants and, to a lesser extent, from loans. The project was designed to demonstrate alternative forms of financing so that other social enterprises could see the benefits of using them. This was a desirable objective, since helping social enterprises to move from grant funding can help to make those that have income earning ability more sustainable in the long term. Also loans, particularly bank loans, often do not suit of the

needs of social enterprises. This role has been achieved to the extent that the fund itself, and the investments it has made, can be held up as examples. The next step is for this to happen, possibly through conference presentations, ideally delivered jointly with the investee venture.

The second objective reflected a view that there was limited evidence of what was possible in the way of providing the investment capital to social enterprises. The desk research conducted as part of this evaluation found that this was the case. The pilot shows that a wide range of patient capital devices can be used (see section 4.3 above). The imminent final report on Futurebuilders Scotland may offer additional evidence, as might the experience of its counterpart in England (see below).

There were suggestions from some stakeholders that SIS could have been more innovative in the kinds of investment it made, but it is not clear what other kinds of mechanisms could have been tested within a pilot designed to look at patient capital and (if appropriate) equity-like investments.⁴⁸

There was, however, innovation regarding measurement of SROI. The pilot involved an early field-testing of the ACF/nef balanced scorecard. SIS adapted the scorecard to their needs and are planning to use it with all applicants, including those to its core fund.

6.2 Effectiveness of delivery methodology

The delivery methodology consisted of:

- Working with ventures which had been identified during the research leading to the social investment report. This included social enterprises who had registered on the SIS website.
- Meeting the key people in those social ventures to discuss their plans.
- Requesting business plans.
- Helping the social enterprises to improve the business plans where required, and in particular to identify social and financial return.
- Proposing a financing package to suit their needs, which might include a loan and patient capital.
- Completing an investment agreement.

This delivery methodology was effective in that:

- It resulted in two investments in the first operational year, with a further two close to conclusion. Hence, four in total.
- One further investment offer can be taken up when key challenges have been overcome.
- There have been 5 social enterprises which were able to obtain finance or funding elsewhere. In at least two of these cases, SIS helped them to develop their ideas,

⁴⁸ A partial explanation for the difference in perception between stakeholders and SIS about the level of innovation to be attempted may lie in the discussion in the social investment report of “equity-like capital” (*Review Of Social Investment Scotland*, (above), p.16). This can use mechanisms such as share issue, which are perhaps innovative in comparison with the debt-based approaches usually used in the social enterprise financing sector. The report points out, though, that it is appropriate where there is a higher level of prospective financial reward, and also of risk, than in the case of patient capital, and that there were relatively few cases where it could be used in Scotland.

business plans and/or communications with other lenders and funders to the point where the latter reversed an earlier decision not to lend.

There are indications that the time taken to progress applications may have been too long, particularly in the pilot's early days. In at least one case, this led to an investee enterprise incurring costs, to maintain operations while awaiting financing. Feedback from some client interviews suggests that processes have speeded up as the SIS team have learned from experience.

SIS's delivery methodology was effective if measured by customer satisfaction – most social ventures, even those which did not take an investment, were generally happy with their interaction with SIS.

6.3 SIS team expertise in relation to that needed in running the pilot

The SIS team needed these key skills in order to run the pilot effectively

- The ability to analyse financial plans and help social enterprises or develop them at to the point where they were investment-ready. It is clear from the feedback from social enterprises that the SIS team have these skills and they are also reflected in CVs of team members.
- The ability to think beyond the traditional lending solutions. We reviewed the investments made and noted that they covered the range of potential investments from recoverable loans to patient capital (see section 4.1). Perhaps the fact that this was not common knowledge indicates a need to give stakeholders a regular overview of activity within the pilot.

6.4 Assessment of the criteria applied in identifying appropriate social ventures

As mentioned above, potential social ventures which took part in the pilot were either previously known to SIS, or registered their interest on the SIS website. The criteria applied in assessing whether or not they should receive an investment centred around:

- The strength of the business plan, together with SIS's assessment of the likelihood that they would succeed with a venture.
- The ability to pay for the investment, whether by way of interest or otherwise.
- Their ability to obtain the money they need it through a traditional loan route.
- Their ability to identify, and measure, the social impact which would form their social return on investment, which would be linked to remittal of part of the interest charged.

All these are eminently reasonable and desirable criteria. In particular, SIS spent some time helping social enterprises assess what social return they would provide, a very useful capacity-building activity.

6.5 Description of types of funding solutions proposed and agreed for particular social ventures

The funding solutions used are described in section 4.3 of this report. They can be summarised as the use of a variety of patient capital ingredients, as part of a package which also included a traditional loan. Those ingredients included linking repayments to business success and remitting or reducing interest if social outcomes were achieved. Details of all funding solutions proposed, whether accepted or not, are provided in the tables in section 4.2.

6.6 Assessment of outcomes from the ventures which have so far been concluded

As mentioned elsewhere, it is too soon to identify long-term outcomes from the two investments placed. However, it is worth noting that in one case, the venture had no recourse to other funding or financing, and would have closed without the SIS finance. This would have led to the loss of:

- 18 trainees under 24 years old
- 10 trainees over 25 years old
- Movement of 68 trainees per year into full-time employment
- Creation of 20 full-time jobs per year
- Sale of over 1000 reconditioned white goods appliances at an average of 2/3 new price to lower income families and individuals
- One shop and one factory.

Additionally, the venture in question will open two more shops by the end of 2007 as a direct result of the investment. Furthermore, the increased working capital has permitted a steep rise in stock turn.

6.7 Identification of what can be learned from approaches to social ventures that did not result in investment

There are several learning points from the approaches which did not lead to loans:

1. Grants remain a preferred source of capital for many social enterprises. Where a social venture is able to meet its developmental objectives entirely by accessing grant funding, it will almost certainly do so. This is a rational choice, in the short term, because:
 - The apparent cost of the grant is limited to the time spent applying for it and reporting on its use.
 - The information which has to be produced to support a grant application may be less than for commercial financing.
 - A grant funder will usually place a higher value on social returns than a commercial funder.
 - There is less need to demonstrate a profit (from which finance can be repaid) when applying for a grant than when applying for commercial finance. This is particularly

important for social enterprises whose activities carry a comparative market disadvantage, as can be the sometimes be the case when the activity relies on economic activity from people with learning difficulties.

2. The time taken to process an application for finance may put off applicants used to faster decision-making by grant-makers.
3. The process of assisting social ventures can build their capacity to obtain either grant or loan finance. This point is reinforced by comments in the Futurebuilder's Scotland evaluation, to the effect that grants have a role in increasing investment-readiness.⁴⁹

6.8 Identification of the strengths and weakness of the pilot overall in seeking to achieve its objectives

The strengths of the pilot are as follows:

- It led to non-grant financing of two social enterprises that had not been able to access the capital they needed to develop their businesses (likely to be four by the end of 2007).
- It demonstrated that there was a demand for non-loan financing for social enterprises.
- It confirmed that the financing needs and available security of social ventures vary greatly, and that different financing package needed to be prepared for each.
- It showed that if a social venture is interested in accessing financing, instead of grant funding, it is likely that experience in identifying a specific product appropriate to its needs (loan, equity investment or quasi-equity) will be limited.
- It identified that most social ventures lack the experience in preparing fully investment ready business plans which can be accepted without alteration as a basis for financing.
- It showed that there was sometimes a lack of 'joining up' of business plans prepared by social enterprises assisted by specialist business support providers and the requirements of SIS.
- It showed that although many social enterprises understood and were motivated by social return, that they did not necessarily have mechanisms in place for measuring their social outcomes.
- It showed that a comparatively simple form of measurement of social return on investment, the balanced scorecard, could be used to underpin financing for social enterprises at below commercial rates.

The pilot's weaknesses are as follows:

- It was not designed to identify the level of latent demand in the sector, and did not do so. That is fine to a point but there remains a need to identify that demand, if substantial resources (in terms of capital and business support) are to be allocated to a greater level of social investment.
- It did not incorporate enough provision for detailed reporting to stakeholders to ensure they were aware of its precise purpose and its achievements.

⁴⁹ Ekos Limited (August 2007) Evaluation of the Futurebuilders Scotland Funding Programme (Draft Report) p.63

- Earlier investments were slower than clients would have liked or expected.⁵⁰ However, in later activity, these comments are not being recorded and SIS have already applied various new approaches and are developing further tools to assist with faster and clearer processes.

⁵⁰ It is interesting to note that the delivery of Futurebuilders Scotland led to comments that its procedures had been complex and drawn-out. And that this should be addressed in any new fund (⁵⁰ Ekos Limited (August 2007) Evaluation of the Futurebuilders Scotland Funding Programme (Draft Report) pp.63, 68).

7 RECOMMENDATIONS

The recommendations of this report are listed under key headings.

7.1 Product offering

- 7.1.1 That policy-makers consider the value of the SIS approach as a route to achieving the objectives of its economic strategy, and in particular addressing its strategic priorities of a Supportive Business Environment and Equity:
- By assisting social enterprises in key sectors, as identified in the strategy and in the forthcoming key sectors report, where support can make them considerably more successful than would otherwise be the case, and
 - By assisting social enterprises offering supported employment.
- 7.1.2 That policy-makers consider contracting SIS to deliver a significant part of the Scottish Investment Fund in the form of patient capital and other risk products.
- 7.1.3 That, in addition to recommendation 1, policy-makers ensure that a proportion of any new capital be made available without targeting, to allow SIS to assist the social economy as it moves to take advantage of market opportunities, as a way of developing an enterprising sector.
- 7.1.4 SIS ensures that it has or obtains an appropriate quantum of funding ability that creates the ability to provide or help assemble financing packages which could include a mixture of loans, patient capital, risk capital involving greater risk taking for greater social return and targeted use of grants. This should include:
- Loans (whether provided from SIS-controlled funds or through a commercial bank)
 - Patient capital
 - Risk capital offered on a business angel or venture philanthropy model or in other, perhaps more innovative, ways which involve greater risk-taking but offer greater social returns.
 - Grants – see below.

7.2 The role of grants

- 7.2.1 SIS includes development grants as part of a financial package where:
- A grant is required to make the package work.
 - Can compensate for a high level of social return.
 - Is needed to help social enterprises develop their strategies and business plans.
 - Is required during a start-up phase when the risk is too great even for venture philanthropy.
- 7.2.2 SIS holds discussions with grant-makers through the Scottish Funders Forum or otherwise regarding the scope for grant funders to:

- Advise prospective applicants that where they may be able to operate commercially, an application for financing might be more appropriate.
- Offer grants which assist social ventures to become investment-ready.
- Make grants available on a declining scale to social ventures that are accessing financing (from SIS or elsewhere), where they need time to develop their income-generating activities to a level which pays for their socially-beneficial activities.

7.2.3 SIS holds discussions with Futurebuilders England regarding their experience of in providing different kinds of grants to support early stage social enterprises.

7.2.4 SIS holds discussions with significant providers of grant funding, including the Big Lottery and Lloyds TSB Foundation, whether their grants might be directed to help social enterprises reach the point where they are able to receive and repay financing. This should include a discussion of whether a fund that might make its grant conditional upon a financing package being taken up at a later stage.

7.2.5 Policy-makers consider the respective roles of grant and patient and equity-like investment as they refine the detail of the new Scottish Investment Fund. In particular, they work with SIS to ensure that any grant element increases the propensity of social enterprises to seek such investment, rather than reduces it.

7.2.6 SIS take into account the conclusions of the Futurebuilders Scotland evaluation in designing its future product offering.

7.3 Product delivery

7.3.1 SIS continues to review its procedures for assessing applications to simplify and speed up the process.

7.4 Marketing

7.4.1 SIS work with appropriate intermediaries, including government-funded social enterprise support organisations and referral agencies such as First Port, to increase awareness of the availability of SIS investment finance.

7.4.2 SIS increases awareness of the financing it can offer through presenting at conferences, and running events and seminars.

7.4.3 SIS continues to emphasise that it can take an innovative and entrepreneurial approach to creating a financial package which is appropriate to each individual social enterprise. Using this approach it should not, therefore, market a range of financial 'products'.

7.5 Skills enhancement

7.5.1 SIS considers augmenting its existing skills set by adding team members with a background in social enterprise and in venture capital or venture philanthropy. This could either be through recruitment or secondment and the benefit would be to enable SIS to offer a wider variety of financing solutions to social enterprises.

7.6 Partnership working

- 7.6.1 SIS and other stakeholders consider continuing the Development Partnership approach demonstrated by the Equal Social Economy Scotland and in particular the Access to Finance Thematic Board.
- 7.6.2 Other organisations offering finance to the social enterprise sector, including significant grant funders, be invited to join any new development partnership. This would help maximise the opportunity to coordinate financing packages comprising capital from different sources.
- 7.6.3 SIS discuss with other providers of finance beyond grant funding (including CDFIs and Lloyds TSB Foundation's Henry Duncan Initiative) how they can work together to provide complementary, rather than competing, finance to the social enterprise sector.

7.7 Business support

- 7.7.1 Either:
- Funding be identified to enable SIS to work with social enterprise business support providers to ensure that they are fully conversant with SIS requirements for social enterprise business plans.
- 7.7.2 Or:
- SIS obtain grant funding to allow it to establish a separate pre-investment support section able to offer specialist advice and support to social enterprises in preparing business and financial plans.
- 7.7.3 Funding be provided to ensure that high-quality post-investment support is available to investee social ventures at a level which reflects the need of the venture and the risk run by SIS. This support should be provided either by a specialist support provider or by high quality volunteer mentors, or by private sector professionals. Where appropriate, mentors should be Board Members of investee ventures.

APPENDIX 1: SOCIAL ECONOMY SCOTLAND⁵¹

Social Economy Scotland is a Development Partnership (DP) supported through the second round of the European EQUAL Community Initiative. The DP focused on influencing mainstream agencies in terms of supporting the development of the sector. The ultimate aim of the DP will be to achieve policy impact at local, national and European levels.

Social Economy Scotland is acting collectively to plug gaps in provision and to test out new approaches to developing the social economy in Scotland through transnational cooperation. To support its work, Social Economy Scotland has secured £2.5 million from Equal Community Initiative funding for the period July 2005 – Dec 2007.

Strategic Aim

Through partnership working and transnational cooperation, Social Economy Scotland supports the social economy to increase its role in the delivery of *innovative, high quality services*, thereby *enhancing its contribution to community regeneration, sustainable economic development and labour market integration* in Scotland.

Underpinning the objectives and to ensure that the DP prioritises support to achieve greatest policy impact, partners have selected five priority themes.

- Partnership and Procurement
- Access to Finance
- Quality and Impact
- Business Development
- Raising the Profile.

The Steering Group Comprises Key Strategic Agencies:

- *Careers Scotland*
- *Forth Sector*
- *Highlands and Islands Enterprise*
- *North Lanarkshire Council*
- *Scottish Centre for Regeneration (Communities Scotland)*
- *Scottish Council for Voluntary Organisations (Lead partner)*
- *Scottish Enterprise*
- *Scottish Social Enterprise Coalition*
- *Social Firms Scotland*
- *Social Investment Scotland*
- *Social Enterprise Team at Scottish Government*
- *Volunteer Development Scotland.*

⁵¹ The information in this section was provided by SCVO, the lead partner.