

WHAT THIS PAPER IS ABOUT

This paper is a business case approved by the WMCA Board in November 2021. The context is as follows.

In February 2018 the WMCA Board established an independent Social Economy Taskforce to help the combined authority understand the contribution that the social economy could make to its commitment to foster inclusive growth in the region. In January 2020, the WMCA published six recommendations arising from this work, each designed to contribute to the goal adopted by the WMCA of doubling the size of the region's social economy – from around £3.5bn to £7bn – over the next ten years. Following this valuable exploratory work, WMCA commissioned a team of sector experts to develop a plan that would enable social economy growth of this scale to be achieved. For further information about WMCA objectives in growing the social economy see the following:

This plan, *Growing the Social Economy in the WMCA area: A Framework for Action*, was published in November 2021 and is available at the links below:

‘Launch of new strategy to help create a better place for everyone across the West Midlands’, WMCA blog post, 25/11/21: <https://bit.ly/3Dp8HfD>

Growing the Social Economy in the WMCA area: A Framework for Action (June 2021) – full report: <https://bit.ly/3DqggCF>

At the same time as the social economy growth plan was adopted, four more detailed business cases proposing specific actions were also agreed. These business cases cover the following:

- Developing and supporting social economy clusters in the region.
- Establishing a new regional social economy development fund.
- Establishing a regional social enterprise support programme.
- Using WMCA regional investment programmes to stimulate social economy growth and new markets.

WMCA
31/03/22



ESTABLISHING A WEST MIDLANDS SOCIAL ECONOMY DEVELOPMENT FUND A DISCUSSION PAPER FOR WMCA

iSE Research Team for West Midlands Combined Authority
22nd June 2021

1.0 BACKGROUND & CONTEXT

At the end of October 2020 a consultancy team led by iSE and consisting of Sarah Crawley (iSE), Meena Bharadwa (Locality), Carole Donnelly (CJD Consulting), Alun Severn (Third Sector Services), and Charles Rapson (School for Social Entrepreneurs), was awarded a contract by WMCA to undertake work which would help develop the Authority's social economy growth plans.

This followed on from work begun by WMCA in February 2018 when the WMCA Board established an independent Social Economy Taskforce to help the authority understand the contribution that the social economy could make to supporting inclusive economic growth in the region.

Following intensive scoping research and regular discussions with WMCA Officers we produced a strategy document called **Growing the Social Economy in the WMCA Area: A Framework for Action** (June 2021). This sets out an ecosystem approach to enabling social economy growth. Based on this report we were asked by WMCA Officers to furnish business cases for projects that would begin to lay the foundations of this ecosystem approach and have produced three:

1. Developing social economy clusters in the WM region.
2. Establishing new regional social economy growth and accelerator programmes.
3. Utilising WMCA regional investment programmes for social economy growth.

In addition to these detailed business cases we were also asked to produce a paper considering the merits of establishing a 'regional revolving investment pot', similar to the Liverpool City Region Kindred LCR fund, a £6.5m investment platform aimed at supporting and growing 'socially trading organisations' in the Liverpool city region, developed by LCR Combined Authority in conjunction with partner Power to Change to establish.¹

¹ See: www.powertochange.org.uk/get-inspired/better-places/liverpool and www.kindred-lcr.co.uk. The Heseltine Institute and Power to Change have just published (June 2021) an updated financial profile of the community business sector in the LCR. While this does not comment on the operational detail of the Kindred LCR fund it does give a very good indication of the calibre of financial profiling and analysis that underpins its continuing development. See: *Financial analysis of the Liverpool City Region community business market*. Helen Heap and Dr Alan Southern, Heseltine Institute, University of Liverpool/Power to Change (June 2021). https://www.powertochange.org.uk/wp-content/uploads/2021/06/PTC_Financial_analysis_of_LCR_community_business-market-FINAL.pdf.

This **discussion paper** considers the arguments for such a fund, looks at how it should distinguish itself from other existing provision and examines possible methods of delivery.

Because this is being regarded as part of the combined authority's overall work around social economy growth we have conceived of this investment pot as being a new regional **social economy development fund**.

2.0 THE CASE FOR A NEW, REGIONAL SOCIAL ECONOMY DEVELOPMENT FUND

2.1 Context

Over recent years the concept of place-based social impact investing has gained traction. There is no single dominant model for this because providers have chosen different ways of approaching the design and operation of such funds, or have come together to collaborate on investment vehicles that they believe best meet their objectives. This is of particular relevance to WMCA for two reasons. First, availability of a dedicated West Midlands development fund would be aligned with the combined authority's ambitions for social economy growth as well as its wider economic, social and environmental priorities for the region. Second, in the West Midlands there is the additional issue of low take-up of repayable loan finance from social investment institutions, driven in part by poor levels of awareness and understanding amongst potential social economy borrowers.

A variety of models

Some existing social finance providers (e.g. Big Issue Invest, Big Society capital) have established their own variants of 'impact funds'. Others, such as Resonance, have focused on developing a range of Social Investment Tax Relief 'SITR funds' serving either specific localities or addressing particular social issues. In Bristol, a partnership between Quartet Community Foundation, Bristol & Bath Regional Capital and Bristol City Council has resulted in the establishment of Bristol City Funds. Currently standing at an available investment fund of £10m, Bristol City Funds brings together the public and private sectors and mixes investment, grant-funding and pro-bono support aimed at making Bristol a fair, healthy and sustainable city. It draws on the expertise of around fifty experts in various business, third sector and investment fields.²

In addition, in 2015 the National Lottery Community Fund, Big Society Capital and Access launched the Growth Fund, with the aim of addressing specific gaps in the social investment market in England – in particular, increasing availability of relatively small amounts (<£150k) of unsecured or small but higher risk finance for VCSE organisations. The Growth Fund utilises a 'blended finance' combining grant and loan funding in a total pot worth at least £45m.

While these and other examples illustrate the continuing evolution of the social finance marketplace, most if not all of these regional or place-specific funds are in their infancy. Our research revealed that detail regarding their operation remains limited and

² See: <https://bristolcityfunds.co.uk>. Also in the public domain is Bristol City Council's business case document for investing in Bristol City Funds. See: CITY FUNDS: Business Case for Bristol City Council Support (May 2019). See <https://democracy.bristol.gov.uk/documents/s33406/Appendix%20A%20-%20BCC%20Business%20Case%20Final.pdf>.

insufficient time has elapsed for evidence of the impact of their lending and/or grant-making – particularly in terms of growth – to be available.³

In terms of what WMCA would like to achieve, Bristol City Funds and Liverpool City Region’s Kindred LCR fund offer the most recent and clearest examples of new multi-purpose, place-based funds combining loans, grants and support.

In the case of Kindred LCR, development has been long and complex, however, partly as a consequence of the collaborative development model adopted (it was developed by and with over 150 socially-trading businesses across LCR) and its community-ownership structure.⁴

3.0 ISSUES FOR WMCA TO CONSIDER

Following the Kindred LCR and Bristol City Funds examples a similar opportunity exists for WMCA to establish a new independent, regional development fund specifically targeting the support and growth of the social economy. However, to be genuinely worthwhile, any new fund must distinguish itself from other existing provision. The Good Finance website alone identifies that the West Midlands is served by 43 local funds and 73 national funds.⁵ The widely reported low take-up of social finance (which typically means loan finance) in the West Midlands is therefore clearly not attributable to a lack of available funding and other factors must be involved. This paper considers those (below).

In light of this, a new independent WM fund cannot be considered in isolation. In order to be genuinely worth doing – and more importantly, in order to succeed – it would in our view need to meet **three complementary objectives**:

1. The proposed fund should be an independent, multi-purpose vehicle capable of accessing government and other third-party funds.
2. As a lender to social economy organisations the proposed fund should seek to offer products and services that overcome current barriers to social finance take-up.
3. The proposed fund must find a way of enabling potential borrowers and investees to navigate a complex and confusing marketplace, better understand the role of social finance and make better decisions regarding its use.

How these objectives can be met is considered in detail below.

³ Although in the case of the Access Growth Fund interim evaluations during 2019 and again during 2020 indicate that a majority of beneficiaries report that grants/lending have enabled them to maintain or increase levels of income or maintain or increase net assets.

⁴ See: <https://kindred-lcr.co.uk/about-us>.

⁵ See: <https://www.goodfinance.org.uk/investors-advisors>.

1) The proposed fund should be an independent, multi-purpose vehicle capable of accessing government and other third-party funds

- a) The proposed fund should adopt a multi-purpose model based on regional development priorities, aligning investment more closely with regional need and with WMCA's strategic priorities and regional investment programmes (where it already controls the decision-making levers).
- b) The proposed fund will be aligned with and can actively support priorities outlined in the other three business cases being presented to the WMCA Board. For example:
- **'Utilising WMCA regional investment programmes for social economy growth'**: opportunities exist to invest in and support new markets in the circular economy (in particular the sharing economy and food), in retrofitting provision and in strengthening social economy supply-chains in house-building. A further significant opportunity exists to incorporate an emissions 'insetting' fund as a means of boosting social economy delivery of retrofitting.
 - **'Developing social enterprise clusters in the West Midlands'**: opportunities exist to invest in and support the development and strengthening of social economy clusters in designated localities, enabling local social economy organisations to scale, grow, inter-trade and access new markets.
 - **'Establishing a regional social economy growth accelerator programmes'**: opportunities exist to invest in and support high-growth social economy organisations that are supported and referred by the proposed Social Economy Growth Accelerator programme.
- c) The proposed fund should be capable of accessing government and other third-party funds and should seek to maximise the impact and recycling of these funds in line with regional development priorities. The fund should aim for an active portfolio of loans and development funds of £10m in the first three years. (Kindred LCR managed to launch with available funds of £6.5m; Bristol City Funds with available finance totalling £10m. Given the larger geographic and economic area of the West Midlands, the potential for mixed funds including government, Member Authorities, the private sector and the independent philanthropic sector, we believe a target of £10m in available funds over a three-year period to be achievable.)
- d) The chosen structure should enable independent decision-making regarding the nature, purpose and terms and conditions of funding/investment, thus enabling gaps in the marketplace to be plugged and funding/investment to be guided by WMCA regional development priorities.⁶ Operation of the fund should be predicated on:

⁶ Given that there is increasing evidence of collaboration amongst some social finance providers it might be argued that rather than establishing a new fund WMCA should encourage existing providers to work together

- Supporting social economy growth, employment creation, social impact and extending regional reach.
- Supporting social enterprises and other types of social economy organisations that operate for social good rather than personal profit.
- Widening the effective marketplace for social finance amongst social economy organisations.
- Plugging market gaps and addressing market failures in existing social finance provision.
- Establishment of a regional development perspective in addition to a loans portfolio.

2) As a lender to social economy organisations the proposed fund should seek to offer products and services that overcome current barriers to social finance take-up

- a) It should seek to counter the low take-up of social finance by social enterprises in the West Midlands by offering new and different financial products that more closely meet their needs. In particular, by investing in and supporting social economy organisations coming through the proposed Social Economy Growth Accelerator programme a means exists to identify and target those displaying growth ambitions and potential and to put into practice ‘blended finance’ approaches that combine loans, grants and support. New products/services should include:
- ‘Blended finance’ models that offer not just loans but access to grant support (incentivised by making grant access dependent on achieving targets for increased trading) and other forms of support, mentoring and pro-bono assistance from experts in their fields (e.g. finance, HR, private sector, VCSE – this is very much the collaborative support model adopted by Bristol City Funds).
 - Access to working capital for cashflowing social economy organisations involved in the delivery of public service contracts where payment in arrears can sometimes mean that organisations need to find huge sums (£500,000-£700,000 is not unusual) to cashflow contracts.
- b) The cost of social finance, which many potential social economy borrowers consider to be unaffordable, should be addressed by ensuring that interest rates on borrowing are capped at the lowest feasible level to enable recycling of loan capital.

more closely in support of WMCA’s own regional priorities. We do not believe that such an approach would be successful.

3) The proposed fund must find a way of enabling potential borrowers and investees to navigate a complex and confusing marketplace, better understand the role of social finance and make better decisions regarding its use

- a) Poor levels of understanding of social finance amongst potential users and a lack of unbiased, objective advice and guidance that would genuinely aid financial decision-making are major obstacles that come up time and again in discussions with the sector. Some existing initiatives, such as the Good Finance⁷ website, have sought to address this problem but generally speaking have not made this complex and still rapidly evolving marketplace more easily navigable.
- b) While the proposed WM Fund cannot hope to solve the information requirements of the entire social finance sector it should ensure that its own operation is underpinned by:
- Adequate guidance, ideally including some form of ‘brokerage’ and introduction service, to enable potential users of social finance to navigate the marketplace. It may be possible to achieve this if WMCA encourages social finance institutions serving the WM region to work together more effectively in explaining their offers. This should include information pitched at an appropriate level for social economy Boards, Trustees and Management Committees.
 - Unbiased, objective one-to-one advice to enable better financial decision-making by social economy organisations and their Boards. This could be achieved by ensuring that the proposed social economy growth accelerator programme (subject of a business case to WMCA Board) incorporates a high level of social finance coaching expertise.

4.0 HOW CAN THIS BE ACHIEVED? POSSIBLE DELIVERY MODELS

The case for a new regional development fund operating along the lines sketched out above is clear in that no other course of action will enable WMCA to achieve these same aims. The question is how best to achieve this. This paper cannot explore all the operational variants that might exist – which are in any case beyond our financial expertise – and focuses instead on the limited delivery options that exist. Three main options are set out in the table over-page.

⁷ See: <https://www.goodfinance.org.uk>.

TABLE: Establishing a new, independent regional development fund for social good & social economy growth: Delivery Options

AIM: Establishment of a new, independent regional development fund operating for social good and supporting social economy growth		
Delivery options	Main implications	Achievability
<p>OPTION 1: AN ENTIRELY NEW IN-HOUSE WMCA FUND</p> <p>Entirely owned and managed in-house by WMCA capacity, including all aspects of management, delivery, governance, risk, operation.</p>	<ul style="list-style-type: none"> • Extremely costly. • Long lead- and set-up times. • Good potential for legacy and sustainability but equally it is high risk (both financial risk and reputational risk). • Requires considerable in-house specialist social finance knowledge and expertise. • Assumes successful access to appropriate sources of finance for onwards lending and investment (and for grant packages too if incentivised grants based on achieving increases in trading revenue are included in the model). • Ability to set interest rates and payment timescales. 	<p>Timeframe – at least two years?</p>
<p>OPTION 2: AN ENTIRELY NEW BUT ‘SHARED OWNERSHIP’ FUND</p> <p>A new independent regional development fund in which ownership and delivery is shared with other partner organisations.</p>	<ul style="list-style-type: none"> • Costs are shared and reduced. • Risk is shared. • Direct WMCA control and decision-making likely to be reduced. • Long lead- and set-up times. • Legal costs may be higher because more complex. • Potential for various ‘mutual ownership’ models – e.g. delivery partners, borrowers and/or investors, or wider sector become ‘member-owners’. • Similarities with the models adopted by Kindred LCR and Bristol City Funds. • Still requires considerable in-house specialist social finance knowledge and expertise. • Still assumes successful access to appropriate sources of finance for onwards lending and investment. 	<p>Timeframe could be longer than two years as model is more complex.</p> <p>While costs are reduced and risk shared this option would in all likelihood present a more complex set-up task than Option 1.</p>
<p>OPTION 3: A NEW EXTERNALLY MANAGED AND DELIVERED FUND</p> <p>A new independent regional development fund whose operation, management and delivery is put out to Tender.</p>	<ul style="list-style-type: none"> • WMCA sets terms, conditions and operational priorities of the fund but delivery is the responsibility of the organisation (or partnership) winning the Tender. • Costs would still be considerable but this is lowest cost option. • Reduces requirement for considerable in-house specialist social finance knowledge and expertise. • Still assumes successful access to appropriate sources of finance for onwards lending and investment. 	<p>Quickest option but timeframe still likely to exceed one year.</p> <p>Would require further research (as would all three options) but this could be built into the Tendering exercise – i.e. a 2-part task in which the contractor first designs and recommends operating structures for the fund.</p>

5.0 CONCLUSIONS

1. Based on considerations of cost and achievability, **Option 3** seems most favourable.
2. This approach would have the additional advantage of offering a phased progression route for WMCA in that as part of the Tendering process WMCA can set out precisely what its main aims are in establishing an independent fund and require contractors to include proposals for broad operational models as part of their Tenders.
3. Significantly more expert research than we are able to provide would be required in order for WMCA to better understand possible costs, operational and financial risks, and especially long-term sustainability. Nonetheless, it can be said that a new, independent fund, however delivered, would offer WMCA significant opportunities to:
 - Establish a vehicle capable of accessing, distributing and recycling additional third-party funds.
 - Align investment and support with its most important regional development priorities and with the actions proposed in the three social economy business cases being considered by WMCA Board.
 - Maximise the social and economic opportunities to be derived from new and emerging markets such as house building, fuel poverty retrofit and the circular economy.
 - Ensure access to appropriate support/guidance to enable social economy to make better use of social finance, especially in utilising it to enable growth.

-Ends-

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22nd June 2021
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