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TRANSFORMING OUR ECONOMY:

Financing the social enterprise sector in Aotearoa New Zealand

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Foreword

This report into the capital needs of social enterprises in Aotearoa New Zealand, and recommendations around the financing of the sector going forward, is a welcome contribution to the debate we are currently engaged in about the development of the impact investing sector generally as this asset class moves globally towards centre stage, and the roles of both government, private sector investors and philanthropic foundations in fostering its development. There is no doubt that we need to find new ways of financing the needs of social enterprises, and no doubt of the value social enterprises have in our economy; collectively, we need to change our thinking about how we find the capital to grow the sector, both to help Aotearoa New Zealand meet its obligations under the UN Sustainable Development Goals, and to create a healthy, vibrant, fair and just society for our children, for our children's children, and for many generations to come. Ākina's research is a well-structured set of recommendations and solutions to help us in educating our society about the changing capital needs of enterprises in our country, the decisions we have to make, and how important it is that we recognise the need to find new ways forward without delay.

David Woods
Deputy Chair
Impact Investing National Advisory Board Aotearoa New Zealand

Executive Summary

The social enterprise sector in Aotearoa New Zealand has grown substantially in the past 10 years, particularly since 2014 when the Ākina Foundation (**Ākina**) took on its current form and the Government issued a landmark position statement to support social enterprise. At the same time, it was recognised that many organisations have been operating in a manner consistent with social enterprise principles for decades and, in the case of Māori organisations, for centuries.

The core principle of social enterprise is the pursuit of social, cultural and/or environmental impact over profit. Internationally, governments have recognised that this focus makes social enterprises natural allies in tackling complex problems – from inequality to climate change – and thus have sought to grow the sector using an ecosystems approach.[1] More recently, it has been recognised that social enterprises are also allies in shifting to a regenerative rather than extractive economics, decentralisation and the circular economy – all of these ideas have gained traction at the highest levels.

New Zealand is already harnessing some of the benefits of social enterprise. Ākina estimates that there are around 2,500 social enterprises operating around the country. In 2017, the sector demonstrated its vibrancy and maturity with the successful hosting of the Social Enterprise World Forum in Christchurch. However, because only scattered elements of a supportive ecosystem exist, social enterprises have found themselves challenged by a commercial and regulatory environment where policy and practice are designed for traditional for-profit businesses or non-for-profit organisations.

Chief amongst the challenges faced by social enterprises is the lack of access to capital. Existing funding sources are not meeting their capital needs, and impact investment – which has great promise to serve the investment needs of social enterprise – is fledgling in New Zealand.

There is no doubt that a thriving social enterprise and impact investment sector would add value to New Zealand's communities, ecosystems, cultures and the climate. And unlocking capital from the private sector to fuel enterprises with a track record of (or the potential to generate) impact would aid the Government in its transformative agenda to a new economy that prioritises human wellbeing and a clean, green and carbon neutral Aotearoa.

This report is concerned with clarifying the capital needs of social enterprises in Aotearoa, and identifying the barriers they face in accessing capital. Drawing on primary and secondary research, the report provides a set of key findings and recommendations designed to inform policy and practice that will help overcome these barriers to accessing capital and, in turn, clear the path for social enterprise and impact investment to transform our economy.

1 The term "ecosystem" has been adopted to describe the interrelated nature of components that affect social enterprises: finance, appropriate legal structures and regulations, access to markets, business support, training and research, and education.

KEY FINDINGS

1. Social enterprises and impact investment are an opportunity for the New Zealand Government to address complex problems at a local to national level; to implement its transformative agenda to a new economy; and to achieve the priorities set out in its 30-year vision.

2. Social enterprises are different to many traditional businesses; they prioritise impact over profit in their business plans and financial strategies. Moreover, impact is "baked in" to their mission, in the sense that the core service they provide or goods they produce exist to address specific and often complex problems. Some social enterprises reject traditional business principles of competition and scale, preferring to stay small and build networks as a strategy to maximize impact.

3. Impact investment has the potential to shift our understanding of money and finance as the fundamental drivers of complex problems, to being tools for developing lasting solutions to these problems.

4. This shift in how we think about money and finance is in line with the Government's work on wellbeing indicators (Indicators Aotearoa) and the wellbeing budget. Measurements of success inform economic activity – the development of indicators beyond GDP has the potential to provide an incentive for the development of social enterprise and impact investment.

5. Enterprises informed by Te Ao Māori embody principles in line with social enterprise and with the Government's transformative agenda towards wellbeing measurement. There is opportunity for the wider social enterprise and impact investment sectors to draw on and embed the experience, expertise and unique understandings within Te Ao Māori.

6. The social enterprise sector and eco-system in New Zealand has developed significantly in the past 5 years and is well placed to develop further with significant and growing interest. The new "fwd:" social procurement marketplace launched by Ākina and NZ Post as part of the Social Enterprise Sector Development Programme is the latest sign of a rapidly developing sector that is embracing the significant potential of social procurement.

7. Amongst funders there is a lack of understanding about social enterprise, their capital needs and impact investment. This applies in mainstream commercial business and finance, as well as the philanthropic and the public sectors and this unfamiliarity acts as an overarching barrier to social enterprises accessing capital. It results in a shortage of capital that meets the needs of social enterprises.

8. Impact investors should embrace the social enterprise model as prioritising impact and understand the sector's capital needs: mission aligned, long-term risk capital with returns adjusted to the social enterprises development stage and mission. Such understanding is key so that financial instruments can be tailored to a social enterprise's unique needs, and maximize (rather than compromise) impact.

9. Tailored financing is the best approach to impact investment. This process does not begin with an expected financial return. Rather, the starting point of the investor is how to achieve the impact goals of the venture and the process that follows is about finding suitable financial instruments.

10. Non-returnable finance is also extremely useful in the initial stage of a social enterprise's development (to test products and business plans in the market); to play a de-risking role for investors; and to act as a subsidy for social enterprises addressing a wider failure of the market to deliver desired outcomes.

11. The early growth phases of a social enterprise, when it is "too big for grants and too small for investment" are the most difficult to secure impact investment in New Zealand. Overseas, Philanthropic providers and governments play a pivotal role in providing adjusted investment capital to fill this gap. Alternatively, these finance providers can use a grant or act as a guarantor to de-risk investment in an enterprise, making it more attractive to investors.

12. Commercial finance providers are not currently meeting the needs of the social enterprise sector, with a focus on unadjusted commercial return. This also applies to the emerging impact investment sector in New Zealand. As a result, investors in New Zealand are only serving a thin pipeline of social enterprises.

13. This failure to meet the investment needs of social enterprises is structural. Pioneering impact investors need to be aware that the prevailing philosophy of short-term profit, high growth and scalable business may not always map appropriately into the social enterprise and impact investment space.

14. Social enterprises are not always ready for impact investment (in terms of their capacity to measure impact and to generate financial returns). There is a need for support and education to develop impact investment readiness that will in turn facilitate more investment.

15. There is a major missed opportunity with philanthropic institutions not investing their capital / corpus in the social enterprise sector - this constitutes billions of dollars of potential investment.

RECOMMENDATIONS

1 There is a significant lack of 'impact first' capital in New Zealand. Investors in the position to make impact first investments should consider how they can integrate these into their portfolio. A balance of capital (finance first, impact first and mixed) is a prerequisite for a flourishing and genuine social enterprise sector. In doing so it should be ensured that any barriers to impact investing are actual rather than perceived.

2 Philanthropic organisations to help accelerate development of the social enterprise sector by de-risking impact investments.

3 Government to consider how it can create an enabling environment for private led impact investing. Supporting the National Advisory Board Aotearoa New Zealand and its efforts is fundamental to this.

BARRIERS TO REMOVE

Changes which will remove some of the key barriers to impact investing that exist currently:

4 Clarify fiduciary obligations of community trusts and foundations. The prevalent belief that those holding funds must only invest their corpus for maximum financial return is hindering impact focused organisations from participating in impact investing. The intent of legislation relevant to these points should be clarified.

5 Consider how existing legal structures create barriers to accessing capital for social enterprises, and how these barriers can be removed.

SOLUTIONS TO IMPROVE

New initiatives which would assist in creating an enabling environment for private led impact investing:

6 Consider initiatives to develop impact investing capability for both supply and demand sides of the impact investing market.

7 Consider a government-backed fund for impact investment. This could include government guarantees for impact investment, social impact bonds and specific investment instruments.

8 Review international success of social impact bonds, including the sectors they've proven to be effective in, and explore implementing similar bonds in New Zealand.

9 Consider other ways to incentivise private led impact investing, including applying the French 90/10 model to Kiwisaver investments, or a tax incentive for impact oriented investments.

Introduction

The world is facing unprecedented social and environmental changes. The October 2018 report released by the International Panel on Climate Change underscored the urgency for governments and business to take action, calling for "rapid, far-reaching and unprecedented changes in all aspects of society" in order to limit global-warming to 1.5 degrees Celsius. This will require significant changes in policy, finance and economics - something that New Zealand's leaders have recognised in their statements. Minister for Community and Voluntary Sector, Hon Peeni Henare told the Aotearoa Social Enterprise Forum in October 2018 that fundamental shifts would be required in the way we approach economics and consumption, towards a more inclusive economy that could draw on the experience and practice within Māoritanga.

This recognition of the need for transformational government reflects a broader shift in economic theory internationally, with concepts of regenerative rather than extractive economics, decentralisation and the circular economy gaining traction at the highest levels.

At the level of government policy, New Zealand is showing signs of positioning itself at the forefront of this global shift. Prime Minister Jacinda Ardern aspires to lead a transformational government. Perhaps the most transformational aspect of this government will be the work it is doing in pursuit of a groundbreaking wellbeing budget. In what will be a world-first for a central government, Budget 2019 will go beyond the traditional GDP metric to include metrics from a "Living Standards Framework" such as health, housing, jobs and earnings, safety and environmental quality. On its official Budget page the Government notes it "will measure and report against a broader set of indicators to show a more rounded measure of success, as a country and as a Government."[2]

There are signs that the financial sector also recognises this shift, certainly at the international level where Larry Fink's much publicised 2017 letter to CEOs has left an indelible mark on the investment community. Writing as the head of BlackRock, the world's largest global asset manager, Fink's explicit expectation that every company needs to make "a positive contribution to society" was a landmark in the development of impact investment. In New Zealand too there are signs of change. The research for this report indicated a widespread expectation that the impact investment sector will grow. One interviewee described the potential for a wave of finance to wash over the sector as a result of shifts away from negatively screened investments such as fossil fuels and so on. To some extent this is considered a generational phenomenon with younger investors seen as expecting a social and environmental impact to be built into their return on investment.

In Aotearoa New Zealand, many Māori businesses have long operated in a balance between commercial profit and benefits to the community and our common natural environment. Te Ao Māori provides a blueprint for social enterprise in New Zealand. Similarly, Aotearoa New Zealand could provide a blueprint for the world on social enterprise.

It is very clear that social enterprise and impact investment do have the potential to transform the economy. To be genuinely new, this research suggests that impact investment must be willing to depart from existing structures and orthodoxy. This will have to mean rethinking what investment return means and, more specifically in some (but certainly not all) cases embracing lower financial returns on investment.

For governments that aspire to a transformational role, social enterprise and impact investment should be natural allies. An obvious way to achieve this transition in our economy is for the government to use its unique position as an institutional lender, regulator and major procurement body to kick start, incentivize and support social enterprise and impact investment. Businesses and investors can shift their focus to embrace social enterprise and philanthropy has a role to play as well. And in the longer term, social enterprise and impact investment should be brought into the mainstream, so that they are no longer a subset of the wider traditional enterprise and investment landscape, but are the norm.

The capital needs of social enterprises in New Zealand are pressing and currently unmet. New Zealand's social enterprise sector stands to benefit from a new wave of capital, characterised by a growing desire amongst investors to generate positive social or environmental impact. Termed impact investment, this trend represents an internal effort from the financial sector to reform.

New Zealand's social enterprise sector has been labelled "fledgling" by international standards;[3] its emerging impact investment space even more so. Prior research has indicated that traditional finance providers do not meet the capital needs of social enterprises: trusts and foundations are familiar with grant dependent non-for-profit (**NFP**) organisations; Commercial banks and investors with the for-profit business model.[4]

2 https://www.budget.govt.nz/budget/2018/economic-fiscal-outlook/budget-2019-focus-on-wellbeing.htm
3 M.J. Kaplan, "Growing the Next Generation of Social Entrepreneurs and Start Ups in New Zealand" (Wellington: Fullbright New Zealand, 2013).
4 Annette Culpan, "Social Enterprise Aotearoa - Insights and Opportunities," Working Paper, December 2015; D Jennings, "Community Economic Development: Understanding the New Zealand Context" (Auckland: New Zealand Community Economic Development Trust, 2014).

It is known that the capital needs of social enterprises differ to NFPs and for-profit businesses, but primary research to clarify the sector's capital needs has not been published in New Zealand. Such clarification is important to inform the development of impact investment; if the capital needs of social enterprises are not clearly defined and communicated, it will be difficult for impact investors to grow the social enterprise sector – a sector that has the potential to be pivotal in tackling our own complex problems.

In recognition of this potential, the Department of Internal Affairs has committed to building the sector in partnership with Ākina through the Social Enterprise Sector Development Programme: a three-year programme to establish an enabling ecosystem for social enterprise. This research report is part of the programme's work on "Facilitating access to finance" and has four objectives:

(i) To clarify the capital needs of social enterprises;

(ii) To identify possible sources of capital for social enterprises;

(iii) To identify barriers to accessing sources of capital;

(iv) To propose solutions to barriers and identify steps to overcome barriers for social enterprises to access capital.

STRUCTURE

There are four sections to this report. Section One clarifies the concept of "social enterprise" in a New Zealand context. Doing so is pertinent to the objectives of this report; a lack of understanding or "unfamiliarity" from finance providers is an overarching barrier to capital access. This section also gives a brief overview of social enterprise landscape in New Zealand. Section Two is divided in two parts. First, it clarifies the capital needs of social enterprises in New Zealand. Second, this section takes a critical look at impact investment.

Section Three is also divided in two parts. First, it identifies the sources of capital for social enterprises in New Zealand. Second, it outlines the barriers to accessing each type of external finance identified by interviewees on the demand and supply side. And Section Four is the recommendations in response to the findings on the capital needs of the social enterprise sector in Aotearoa New Zealand.

Methodology

To address each of the four objectives of this report, the authors have synthesised information from secondary and primary research. Most of the findings with regard to capital needs and barriers to accessing capital are informed by primary research.

Three step literature review to inform focus for primary research

(i) General review of existing literature on the social enterprise and impact investment sectors in New Zealand and overseas to get a clear idea of the benefits associated with growing both sectors.

(ii) Targeted review on the capital needs of social enterprises in New Zealand, the sources they use to access capital, and the barriers they face in doing so. Based on the knowledge gaps this identified, the primary research focused on: (i) clarifying the capital needs of sector; (ii) barriers to accessing capital; (iii) the state of New Zealand's impact investment market and whether it is serving the capital needs of social enterprises.

(iii) Solutions focused review of international experiences and best practices with regard to the financing social enterprises, focusing on impact investment.

Process for conducting primary research

Capital needs and barriers to accessing capital are multi-dimensional, so interviews to collective qualitative information were undertaken to answer the research objectives.

(i) **Demand side:** 23 in-depth interviews were conducted with social enterprises, 18 by Ākina in late 2017, and 5 by the authors. Enterprises were selected using purposive sampling and recommendations from within the sector to ensure a varied sample of enterprises, in terms of sector focus (See Figure 1.0).

(ii) **Supply side:** 10 interviews were conducted with finance providers. Providers were selected using purposive sampling (for providers thinking about or already engaging in impact investment).

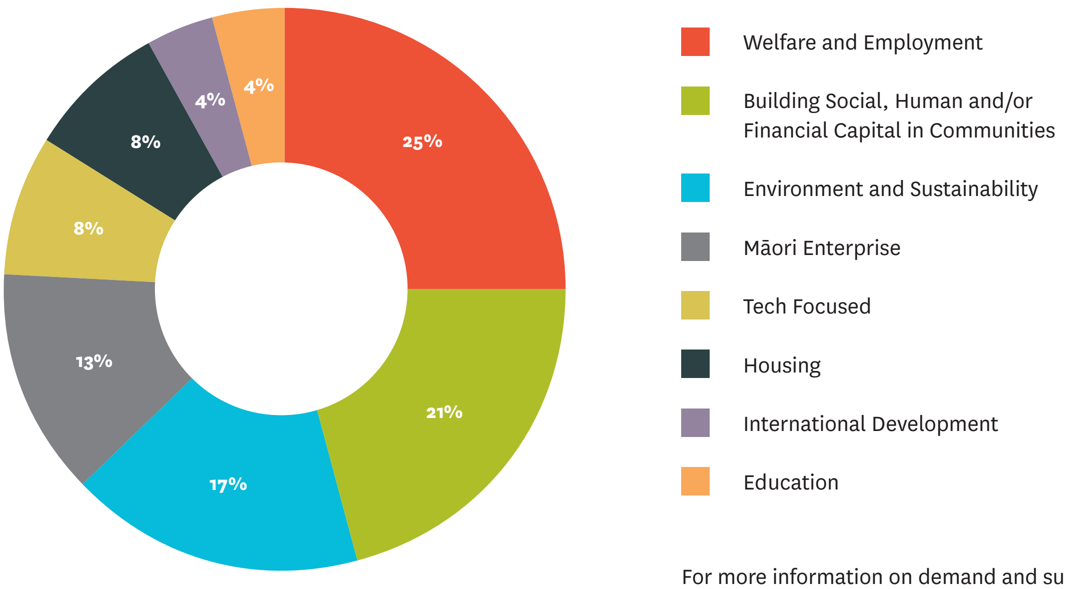

***Figure 1.0:** A variety of social enterprises, in terms of sector, were interviewed.*

For more information on demand and supply side interviews, see the Appendix.

FINANCING SOCIAL ENTERPRISE TO TRANSFORM OUR ECONOMY

In New Zealand, traditional finance providers can be divided into three categories:

(i) **Trusts and foundations** (public and private) provide grants and donations to not-for-profit (NFP) organisations;

(ii) **Commercial finance institutions** (such as banks and Angel investors) invest using debt or equity in for-profit businesses.

(iii) **Government (local and central)** contracts private sector businesses and NFPs for service delivery. These bodies also provide grant funding for community initiatives and small businesses.

Primary and secondary research revealed that all three categories have been "slow to accept the unfamiliar"; there is a lack of conceptual understanding about what social enterprises are.[5]

Social enterprises are distinct from NFPs and for-profit businesses. Their principal objective is to address social, cultural and/or environmental problems, while profit is a means to maximise impact. "Unfamiliarity", according to Anake Goodall, CEO of Seed the Change, is problematic because "all of the support systems and rules [for traditional finance providers] are designed for organisations that are familiar...".

When finance providers do not conceptually understand social enterprise, this is a "real issue" in terms of accessing external capital.[6] Firstly, because finance providers are less willing to fund what they do not understand and, more fundamentally, because a deficit of understanding means that traditional providers (and at times impact investors) are not tailoring financial instruments to meet their unique capital needs. Both of these concerns act as a restraint on social enterprises generating positive impact – and run the real risk that impact investment will only serve a thin pipeline of social enterprises in New Zealand (the latter issue is discussed further in Section Two).

In light of the finding that an understanding deficit is an overarching barrier to social enterprises accessing finance – the remainder of this section aims to shed light on the "unfamiliar". It does so by drawing on the comments of interviewees about the sectors broader purpose, how this fits with the Government's aspirations to be "transformative" and, lastly, a brief overview of what the sector looks like in New Zealand.

WHAT IS THE PURPOSE OF THE SOCIAL ENTERPRISE SECTOR?

A recurring idea between interviewees, on the demand and supply side, is that social enterprises are more than individual organisations with scattered progressive impacts – they are part of systemic change to a new economy:

> **"Social enterprise is about fundamentally shifting economics"**
> **– Shona McElroy, Foundation North**

> **"People are stepping up. When they go out and start a business, the very first thing that is being asked now is purpose. Not profit, purpose.... The old model is distorted [because] the desire to look after others is inherent in all of us"**
> **– Steve Jukes, Pathways**

> **"There is no doubt that the economic model we have been using to date has been hugely productive – it dragged us out of the Stone Age. But, it cannot be extrapolated any further. We need a whole lot of different systematic responses and thoughts about how we do economics. Social enterprises, community based operations and community ownership of activities, are part of long-run solution"**
> **– Anake Goodall, Seed the Change**

> **"There is urgent need to shift away from short-term, profit driven models. We need long-term thinking, and we need to start right now. In 50 years, NZ will be a very different country... Social enterprises look to solve tomorrow problems"**
> **– Bridget Hawkins, ReGen**

The concept of a new economy (once a radical idea) is now relatively mainstream. In August 2018, Prime Minister Rt Hon Jacinda Ardern delivered a speech entitled "working together to build a new economy".[7] According to the Prime Minister, New Zealand needs a plan for transformation:

> **"It is time to retool our economy to make it work within the limits of our environment, shape it to deliver on the hopes and aspirations of all our people, and for our economic purpose to be bigger than just profit."**

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5 Paul Gilberd, NZ Housing Foundation.
6 Anake Goodall, Seed the Change.
7 Jacinda Ardern, "Working Together to Build a New Economy," The Beehive, August 28, 2018, http://www.beehive.govt.nz/speech/working-together-build-new-economy.

In his remarks to the October 2018 Aotearoa Social Enterprise Forum – itself subtitled "Transforming our Economy" – Minister for Community and Voluntary Sector, Hon Peeni Henare spoke about the need for fundamental shifts in the way we think about our economy and the way we manage our consumption.

These comments reflect the views of many academics, scientists, economists and forward-looking thinkers concerned by an economic system that is not evolving to address the challenges governments face in relation to social cohesion and threats to our ecosystems and our climate. According to this growing body of evidence – governments globally face crucial decisions about how to tackle the root causes of these problems and to rebalance the pursuit of commercial success with the pursuit of social and environmental success.

In Aotearoa New Zealand, Te Ao Māori has for centuries provided a road map for a system of production and trade of goods and services that is centred around long-term community and environmental outcomes. This indigenous Māori knowledge and practice offers a comparative advantage to Aotearoa New Zealand in our endeavours to transform our economy and become a world leader in social enterprise.

> **"I feel a lot of Māori organisations have been operating with a social enterprise model for a long time, before that label was created; environment and people first is at the heart."[8]**

SOCIAL ENTERPRISES ARE NATURAL ALLIES TO THE GOVERNMENT

Social enterprises in New Zealand that see themselves as "fundamentally shifting economics"[9] are natural allies for the Government to deliver on its ambitious plan to shift towards a more democratic and regenerative economy. These enterprises are not anti-profit, but they do have their priorities arranged clearly: money is a tool to have impact in the world rather than a resource to accumulate. In contrast to traditional businesses, the activities of such enterprises are non-extractive; they look to the long-term and are driven by the question, "how many benefits – to society, ecosystems and the climate – can we layer into what we're doing?"[10]

Internationally, governments are offering financial support to social enterprises – in recognition that they are more "nimble", innovative and locally focused, relative to central Government decision-makers (who tend to be removed from local realities).[11]

On the latter point, social enterprises can facilitate community level choice about production and income distribution. Several interviewees remarked that social enterprise is a new name for Community and Economic Development. Entrepreneurs in this space take a participatory approach to problem solving, based on the logic that the people affected by environmental, social or cultural problems offer valuable insights into solutions. When supported to take action, communities are unsurprisingly apt at driving positive change; it is they who stand to benefit. This bottom-up approach to development results in communities owning their problems, solutions and activities – for one interviewee such ownership, to build confidence and to empower, is a core characteristic of a social enterprise.[12]

Due to this alignment of interests, many overseas Governments have taken active steps to better enable social enterprise, and specifically from an investment perspective in many instances. Australia provides a recent and relevant example, where their 2017-18 Budget included AUD$30 million to fund social impact investing over the next 10 years. AUD$8 million of this was for investment readiness, with the remaining AUD$22 million to support both the growth of the sector and specific opportunities.

This research identified several enterprises that have stepped up to deliver goods and services and there is many more operating in New Zealand. Table 1.1 provides an insight into some ventures aligned to the Government priorities in its 30-year vision. Some of the enterprises listed in this table do receive Government support – however all commented that not enough capital is a major barrier to maximising impact.

8 Research participant, anonymous
9 Shona McElroy, Foundation North
10 "Episode 2: Kate Raworth on 'Doughnut Economics,'" TheNextSystem.org, accessed September 2, 2018, https://thenextsystem.org/learn/stories/episode-2-kate-raworth-doughnut-economics.
11 Agapitova Agapitova, Belén Sanchez, and Elaine Tinsley, "Government Support to the Social Enterprise Sector: Comparative Review of Policy Frameworks and Tools" (Washington, DC: World Bank Group, 2017).
12 Anake Goodall, Seeds for Change.

Priority or point in 30-year vision	Social enterprises that will help drive towards delivering on the plan
To grow and share more fairly in New Zealand's prosperity, helping people into employment	**Pathways** was founded in 1998, when Steve Jukes and fellow co-founders purchased an old furniture manufacturing company to hire people in Christchurch struggling to find employment. Their mission was to give people committed to changing the direction of their lives "a fresh start"; this remains the mission statement of Pathways, which has now expanded its services to provide holistic support: accommodation, social work support, mentoring, drug and alcohol counselling, prisoner reintegration and restorative justice.
	Kilmarnock Enterprises helps school leavers with learning disabilities to find meaningful employment. Kilmarnock believes in providing their employees with professional training, social development, health and wellbeing initiatives and on-going support.
	Cultivate Christchurch addresses the lack of employment training and work experience for young people considered "high-risk of never being employed". Last year, its youth programme produced ten successful transitions to employment for young people. Using Treasury data, it estimated this success at a $1.3 million saving to the taxpayer for Corrections and Welfare Costs alone.
	More generally, social enterprises are beneficial to shared prosperity, because money is retained in the community, their benefits are inclusive, and it is a "sustainable and sound economic model". A participant in 2015 research in Northland commented in support of these benefits:[13]
Regional Development plus a clean, green, and low carbon economy and climate	**ReGen** creates world-class, technology-based solutions for the agricultural sector. Its purpose – to clean up New Zealand's waterways and prevent Nitrogen leaching – "sits at the core" of ReGen's business model and financial strategy. In the longer-term, ReGen aims for farmers to become caretakers of the land. Its core products include award winning "Regen Effluent" (prevents ponds from overflowing and over-irrigation of dairy effluent) and nitrogen application management. Currently, ReGen has 18,000 ha of farmland under management.
	Blueskin Energy is a social enterprise operating north of Dunedin that was established by the Blueskin Resilient Communities Trust to develop local renewable energy projects. In 2015, Blueskin lodged an application with the Dunedin City Council seeking consent to construct a small-scale wind farm. The wind farm would be community-owned, managed and generate an income stream by selling electricity into the local grid. The profits would flow back into the community in the form of energy trust dividends cheques. Consent was declined on the basis that it would "interfere visually with the landscape". To transition to a low-carbon economy, community renewable energy projects can collectively have a big impact (evidence from the Nordic countries demonstrates community participation is essential to drive the clean energy agenda, and has flow on benefits in terms of people living more sustainably).[14]
Healthier, safer more connected communities plus everyone has a warm and dry home	**The New Zealand Housing Foundation** assists people who would not otherwise be able to afford a home to make this a reality. To date, it has built 750 homes and has 400 people in its programmes (Affordable Equity or Rent to Buy); 127 families own their own home. Beyond helping people into a home, the Foundation aims to foster "mixed, integrated communities" and to improve the wellbeing of individual families. Subsequent evaluation of its housing developments demonstrates success in these respects: increased participation in community life, greatly improved health, a reduction in school absenteeism, an increased sense of security and overall wellbeing.
Better connections with iwi	A recent report, Te Manu Ka Rere: Fostering Māori Enterprise Financial Capability, found that Māori enterprises play an important role in achieving Māori aspirations of financial independence and self-determination, and "needs to be a priority for economic development agencies around New Zealand".[15]
Improving wellbeing, mental-health	A dearth of literature has been written on the connection between work satisfaction and mental health.[16] Millennials in particular are seeking "meaning" in their work (employment that aligns with one's personal values). Work with meaning is associated with decreased stress and improved mental wellbeing. 73% of New Zealander say it's important for them to work in a company that is socially and environmentally responsible.[17] Social enterprises put the environment and people at their heart; we need more of them (and to grow existing enterprises to maturity) to increase avenues for meaningful work in New Zealand.

Table 1.1: *Core ideas of social enterprises plus examples that align with the Government's 30-year vision.*

13 Annette Culpan, "Social Enterprise Aotearoa - Insights and Opportunities," Working Paper, December 2015, 78.

14 "Power to the People - How to Make the Low-Carbon Energy Transition Work," sciencenordic.com, accessed November 1, 2018, http://sciencenordic.com/power-people-how-make-low-carbon-energy-transition-work.

15 Massey University, "Māori Enterprise Study Identifies Support Gaps," Press Release, September 4, 2018.

16 Guy Standing, The Precariat: The New Dangerous Class (A&C Black, 2011); Madeleine Bunting, Willing Slaves: How the Overwork Culture Is Ruling Our Lives (HarperCollins UK, 2011).

17 Colmar Brunton, "Better Futures," 2017.

WHAT DOES THE SOCIAL ENTERPRISE SECTOR LOOK LIKE IN NEW ZEALAND?

Social enterprise is not new to New Zealand. Before Europeans arrived in the late 1700s, with their own ideas about production, consumption and how to live well, Te Ao Māori informed the economy. A Te Ao Māori approach would recognise the way humans are connected to each other and to the natural world.[18] The responsibility to care is fundamental, for the members of one's whanau, hapu and iwi, especially the vulnerable, and for the lands in which one is mana whenua – these are held on trust for future generations.[19] These responsibilities form the foundation of the Māori economy today: kaitiakitanga (stewardship); manaakitanga (supporting people); mahi aroha (working for the collective good); and taonga tuku iho mō ngā uri whakatipu (guardianship of resources for future generations). Businesses informed by these values do not put profit first (though collectively, Māori business is valued at well-over $42 billion), but seek to add value to communities and the environment by taking a long-term view (50-100 years or longer). Many are "whanau centred" and aim for indigenous self-determination.[20]

This concept of business reflects the ideas discussed above of a new, more democratic and generative economy.[21] There is work to do to clarify *what is and what is not a social enterprise*.[22] At present, delineating lines are difficult to draw – anything can be a social enterprise, provided some aspect of the business "is doing good in the world".[23]

The proposition of delineating characteristics for social enterprises is beyond the scope of this report, however the authors recommend further conversation is had on this subject. All interviewees saw benefit in defining social enterprise; either to protect the term from being co-opted by for-profit business models or, on a practical level, to enable Government targeted supports.[24] More than one commented to the affect that Te Ao Māori is "naturally in a position to lead the social enterprise sector".[24] The authors agree. Te Ao Māori is a valuable pool of knowledge, unique to New Zealand, from which we can draw to give the sector greater clarity and integrity. Doing so would also align with the Government's intention for the new wellbeing indicators to embody Te Ao Māori.

Ākina estimates that there are now 2,500 social enterprises in New Zealand based on its inclusive definition of organisations with a primary purpose to achieve impact, generating the majority of income from trade, and reinvesting the majority of profit back into the mission. Beyond Māori enterprise, social enterprises can be classified as community enterprises (locally based NFPs with a trading arm, often providing welfare services) and enterprises operating as businesses to solve complex problems. The latter category is more capable of generating revenue, however profit remains a means to maximise impact:

> **"We flip the business model around so that impact to the wider community comes first"**
> **– Bridget Hawkins, ReGen**

18 Piripi Whaanga, "Māori Values Can Reinvigorate a New Zealand Philosophy" (Victoria University, 2012), http://researcharchive.vuw.ac.nz/handle/10063/2403.

19 Customary authority exercised by an iwi or hapu in an identified area. This customary authority emanates through whakapapa (genealogy) and is exercised as kaitiakitanga (guardianship).

20 Pushpa Wood and Jason Mika, "Te Manu Ka Rere: Fostering Māori Enterprise Financial Capability" (Massey University and Fin-Ed Centre, 2018).

21 Suzanne Grant, "Social Enterprises in New Zealand - An Overview," Social Enterprise Journal 13, no. 4 (2017): 410–26.

22 Teresa Tepania-Ashton, CEO Māori Women's Development Inc.

23 Simon Day, Social enterprise: the future of capitalism?, September 29, 2017, https://thespinoff.co.nz/business/29-09-2017/social-enterprise-the-future-of-the-capitalism/.

24 Bridget Hawkins, CEO Re Gen made this comment. Similar views were expressed by Tepania-Ashton, CEO Māori Women's Development Inc. and John McCarthy, Manager Tindall Foundation.

SECTION TWO

WHAT ARE THE CAPITAL NEEDS OF SOCIAL ENTERPRISES IN NEW ZEALAND AND CAN IMPACT INVESTMENT MEET THEM?

This section is divided into two parts: (i) The capital needs of social enterprises; (ii) A discussion on whether impact investment is meeting identified needs. Both parts draw on overseas literature and reports from New Zealand academics, but are principally informed by primary research.

CLARIFYING THE EXTERNAL FINANCE NEEDS OF SOCIAL ENTERPRISES

Access to external finance is indispensable for social enterprises to evolve from start-up to sustainable operation.[26] In New Zealand, a lack of support from public and private finance providers means that access to finance is perceived as one of the biggest challenges to the sector's success. This perceived constraint has been identified by earlier research on the sector[27] and more recently by the Impact Initiative's poll, "what does the social enterprise sector need?"; the most common response (37%) was access to finance.[28]

In some cases, the perceived constraint on accessing external finance could reflect underlying problems relating to an organisation's ability to generate income from trading or to manage the business effectively. This makes it all the more important to facilitate an ecosystems approach to grow the sector.[29] However, such difficulties should not discount the important role the right type of external finance plays at each stage of development for a social enterprise,[30] nor the difficulties in accessing finance, relative to traditional businesses and NFP organisations. Ultimately, difficulties can be traced to a lack of understanding about the external financial needs of a social enterprise. This section seeks to provide clarity on this front – a necessary first step for the emerging impact investment market to serve the growth of the social enterprise sector in New Zealand.

The right type of finance at the right time

The external finance needs of a social enterprise evolve as it progresses from dependency to independence.

At the **start-up phase**, social enterprises have a rough blueprint for generating impact and may require high risk capital.[31] This plays a crucial role in enabling ideas to be actioned: developing prototype products and services to test in the market place; initial marketing; accessing technical assistance; and developing a business plan and methodology for measuring impact.
Non-returnable finance, in the form of a grant or donation, is an extremely useful form of capital. Usually, only small amounts of money are necessary at this stage of development – "it is more about time and hard work to get the enterprise investment ready".[32] Thus, self-funding is also an option at this stage of development. In communities with low social and financial capital, it is more difficult to access external finance to start an enterprise, relative to more affluent areas. Targeted Government funding to address this capital deficit (for example, hardship in low socio-economic areas) can play a valuable role in levelling out the playing field.[33] More broadly, non-returnable finance is useful to social enterprise (at all stages of their development) seeking to address market failures; "this requires putting more money into the venture to have an impact", relative to a for-profit business. Anna Guenther, CEO of PledgeMe, and Paul Gilberd, General Manager of the New Zealand Housing Foundation, made this point.

At the **validation phase**, an enterprise will discover whether it has a product or service that works – in the sense of delivering impact plus identifying customers that are willing to buy at a sufficient price to support it in the long-term. Due to the high degree of uncertainty at this stage (which often requires ongoing innovation, refinement and testing), the enterprise may not be compelling enough for commercial lenders or investors. Thus, non-returnable finance can play an important role at this phase of a social enterprises development also.[34] Two interviewees noted that grants play an "important role in de-risking an enterprise – it makes them more attractive to investors".[35]

Comments from demand side interviewees suggest that grants

26 Ingrid Burkett, "Financing Social Enterprise Understanding Needs and Realities," Foresters Research Report (Brisbane: Foresters, 2010).
27 Jennings, "Community Economic Development: Understanding the New Zealand Context"; Culpan, "Social Enterprise Aotearoa - Insights and Opportunities"; Kaplan, "Growing the Next Generation of Social Entrepreneurs and Start Ups in New Zealand."
28 The Impact Initiative, "Your Response So Far," The Impact Initiative, accessed September 10, 2018, https://www.theimpactinitiative.org.nz/programme-updates/response-to-the-launch-of-the-impact-initiative.
29 Hillary Brown and Emma Murphy, "The Financing of Social Enterprises," Special Report (Bank of England, 2003).
30 Jennings, "Community Economic Development: Understanding the New Zealand Context" (Auckland: New Zealand Community Economic Development Trust, 2014), 58.
31 A Gianoncelli and P Boiardi, "Financing for Social Impact: The Key Role of Tailored Financing and Hybrid Financing" (Europen Venture Philanthropy Association, 2017).
32 Anna Guenther, PledgeMe.
33 Gines Haro Pastor, "Best Bits: Social Enterprise in Deprived Areas," The Guardian, 2011, sec. Guardian Sustainable Business, https://www.theguardian.com/social-enterprise-network/2011/oct/05/best-bits-social-enterprise-deprived-areas; Frank Villeneuve-Smith and Nick Temple, "Leading the World in Social Enterprise" (Social Enterprise UK and Santander, 2015).
34 Kaplan, "Growing the Next Generation of Social Entrepreneurs and Start Ups in New Zealand," 32.
35 Aroha Armstrong, Callaghan Investment.
36 Jennings, "Community Economic Development: Understanding the New Zealand Context."

in New Zealand do not meet the needs of social enterprises. Trusts and foundations (the principal providers of non-returnable finance) are familiar with serving the NFP sector and tend to tie grants to a specific project or use.[36] This hinders the capacity of a social enterprise to experiment and innovate – a must to develop a product or service that delivers maximum impact to its intended beneficiaries. For example, the Manager of Te Hou Ora Whanua Services, a kaupapa Māori provider, commented that "untagged funding would be helpful to trial more innovative projects... [like] setting up internet access for low-decile children who currently have no access". The need for flexible grants is reflected in Di Jenning's 2014 Community and Economy Report (**CED Report**). She found that some philanthropic providers are too risk averse to fund innovation:

> **"Innovation is punished by some funders. It was hard to get them to buy into innovative things. Their criteria were restrictive."**

A further need at the start-up and validation phases of a social enterprises development is for funding to be tied to support:

> **"We are looking for finance with expertise attached. We would like mentoring as part of the deal to help us to be accountable – and succeed"**
>
> **– Chairperson, Project Lyttelton**

> **"Businesses need to help social enterprises figure out how to measure their impact. It would be helpful to have a community to learn from. The money alone is not enough"**
>
> **– Bridget Hawkins, ReGen**

> **"To me, the biggest thing is advice and knowing when it is helpful. Advice now is more helpful. Also [advisors'] networking and credibility is hugely important"**
>
> **– Dave Cameron, Learn Coach**

It is well documented that capital works best when coupled with support: financial and impact advice, access to networks (to potential investors and new markets), and help creating impact measurement methodologies (to verify impact). Most supply side interviewees were aware of this need and do offer support:

> **"People do not know you at [the start-up] stage of development. I can write letters of recommendation, and help with building their credibility.... Bringing reputation and voice to start-ups really matters"**
>
> **– Anake Goodall, Seed the Change**

> **"We sometimes act as an advocate for the enterprises we fund. The New Zealand Housing Foundation is a good example; we try to promote them a fair bit. We can leverage our reputation and experience with the New Zealand Housing Foundation to help people understand the value of their housing products. Sometimes we can also bring other funders into the mix for the enterprise"**
>
> **– John McCarthy, The Tindall Foundation**

Section Three of this report talks further of the barriers to accessing grant funding for social enterprises in New Zealand.

Revenue from trade is not enough – growth requires external capital

At the **growth phase** of a social enterprise's development, grants are not the right place to look; typically, the sums of capital required for growth far exceed that of non-returnable finance. Thus, like a normal business, social enterprises seek investment finance in the form of debt (by taking out a loan) or equity (via the sale of company shares).[37] Equity tends to be a more viable option for companies prior to or just starting to trade, as serving a loan requires a reliable revenue stream.[38] At this phase of development, a "social enterprise can need a lot of capital for a long time to get to the point where they are sustainable."[39]

Social enterprises' investment finance needs do not mirror traditional businesses

The principal limitation of investment finance for social enterprises is that it has been designed to meet the needs of traditional business with a single bottom line: the maximisation of profit. Social enterprises have multiple bottom lines – meaning that they purse a mixture of economic, social, environmental and cultural goals – and this has implications on both the demand and supply side of the equation. For the supply side, reservations are held about investing in a social enterprise that corresponds to their common practices (see table 2.1 on page 16):

37 Debt and equity finance can be classified into financial instruments (a monetary contract between parties). Equity-based financial instruments represent ownership of an asset. Debt-based financial instruments represent a loan made by an investor to the owner of the assets.

38 Anna Guenther, CEO PledgeMe.

39 Shona McElroy, Foundation North.

Common practices of social enterprises to meet multiple bottom lines	Implication	Constraint for traditional investment finance providers
Reinvest the majority of profits in the fulfilment of impact-focused mission	Limits on the distribution of profits to company owners and shareholders.	This can generate difficulties in finding financial support, especially for financial instruments where traditional investors expect a share of the assets or profit (equity and quasi equity).
Impact first, profit is a means to achieve impact	Achieving impact often requires long-term planning. Moreover, placing impact first can compromise revenue generation.	Long-termism clashes with traditional investors seeking short-term gains.
Inclusive governance with democratic decision making mechanisms to 'lock in' impact	Social enterprises may adopt the "one member one vote" principle, so that decision-making power is not based on capital ownership.	Limited participation of private investors in the social enterprise decision-making process and business may restrict equity finance and loans.
Collective ownership is commonly adopted by social enterprises, and "is a deeply rooted cultural norm for Māori"[40]	When are assets are collectively owned, this comprises the ability to use assets for collateral (quite simply because it can be difficult to obtain consent from all).	Difficulty raising debt investment; most commercial lenders require collateral. The alternative is finding a guarantor.

***Table 2.1:** Constraints on social enterprises accessing investment finance correspond to their common practices adopted to protect impact-focused missions.*

A further need at the start-up and validation phases of a social enterprises development is for funding to be tied to support:

> **"If your business is solely focused on maximising profit, then the private sector is comfortable with that. If part of what you are driving to... is a more collective good, this makes them concerned – they do not understand the social enterprise model"**
>
> **– Bridget Hawkins, ReGen**

On the demand side, social enterprises tend to avoid mainstream finance providers; they fear that the pressure to generate a monetary return will compromise non-monetary objectives. This fear is commonly referred to as "mission drift".[41]

WHAT KIND OF INVESTMENT FINANCE DO SOCIAL ENTERPRISES NEED?

Table 2.1 sets out the kind of investment social enterprises need to grow and expand their impact:

(i) **Mission aligned investors:** Equity investment tends to be a preferable option for social enterprises that do not have a steady revenue stream (compared to servicing a debt). Equity dilutes ownership, and investors often take a seat on the Board. Thus, mission aligned investors are crucial to preserve and maximise impact.

(ii) **Long-term outlook:** It is readily accepted by policy makers that we need long-term thinking to solve complex social and environmental problems. For social enterprises tackling such problems, especially at a systemic level, long-term thinking necessitates long-term committed capital. Also, long-termism is natural to Māori enterprises. [42] An added benefit of investors committed for the long run is that it frees up considerable time and resources from seeking capital.

(iii) **Willing to take a risk:** Start-ups are always a risky investment; this research suggests more so for social enterprises.

(iv) **A concessionary or adjusted component:** While there is not always a tension between profit and impact, right now for many social enterprises pursuing impact first may compromise maximising revenue generation.

These four needs were identified in overseas literature on the external finance needs of social enterprises, and aligned with demand side interview findings.[43] Table 2.2 on page 17 provides an overview.

40 Jennings, "Community Economic Development: Understanding the New Zealand Context," 66.
41 New Economics Foundation, "Developing a Social Equity Capital Market" (UK, 2006), https://neweconomics.org/2006/11/developing-social-equity-capital-market.
42 Wood and Mika, "Te Manu Ka Rere: Fostering Māori Enterprise Financial Capability."
43 Gianoncelli and Boiardi, "Financing for Social Impact: The Key Role of Tailored Financing and Hybrid Financing"; Strategic Group on Social Enterprise and Social Finance, "Social Enterprise and Social Finance: A Path to Growth" (Department of Internal Affairs, April 2016); Burkett, "Financing Social Enterprise Understanding Needs and Realities"; Paul Brest and Kelly Born, "Unpacking the Impact in Impact Investing," Stanford Social Innovation Review, August 2014, https://ssir.org/articles/entry/unpacking_the_impact_in_impact_investing.

External finance needs identified by demand side interviewees	Comments
Mission aligned: All 23 demand side interviewees commented to the affect that they do not want investors to dictate mission direction or to occasion mission drift; investment needs to be about "partnership... [so both parties] can take pride in social impact".[44] Ooooby, an organisation with the objective of putting "small-scale sustainable farming at the heart of our food system" made the point that getting the right early stage investors is critical to preserving an enterprises mission for the long-term.	We'll consider anyone who's first of all, okay with impact and second of all, making money (CEO, Kai). [We] would consider working with anyone as long as we don't have to compromise the integrity of what we do (Co-Founder, Cultivate). The investor would have to align with our purpose (CEO, Childfund). Compatibility with investors is fundamental... [we would not accept investment] where it felt like the mission was at risk of being compromised (CEO, Ooooby). Values misalignment would be reason to not complete an investment deal (CEO, Kilmarnock Enterprises).
Long-term outlook: 8 interviewees drew attention to the need for long-term finance. Several also commented that short-term investment cycles do not meet their needs; this takes valuable time and resources that could be better spent maximising impact. More generally, a long-term view applies to Māori enterprises: "Many Māori entities are looking at 50-100 years out and how their business will be sustainable and benefit future generations".[45] Interview results also revealed that the need for long-termism applies to central and local Government contracts for services (see comment from Friendship House).	The fact that these loans [10 million from the Tindall Foundation] are long-term and low interest is critical because our products have a 7.5 to 15-year lifecycle (Paul Gilberd, The Housing Foundation). We're constantly walking this balance between putting time and effort into funding applications and putting time and effort into increasing efficiency and effectiveness of our business and operation (Co-Founder, Cultivate). Friendship House, a provider of "living without violence programmes" and numerous community support services, commented that their funding contracts with Ministries are "precarious" because they are "too short-term" to enable long-term planning (Friendship House). Wakatū Incorporation has a 500-year intergenerational plan, Te Pae Tawhiti. "All annual plans have to fit into the 500-year plan, and all our rules around retaining land and assets, as well as debt and equity fit into the 500-year plan. This is not unusual for Māori, but from an investment point of view, investors often want a return on their investment in the shorter term, which does not necessarily fit this long-term plan" (Kerensa Johnston, Chief Executive, Wakatū Incorporation).
A concessionary or adjusted component: Not all interviewees need adjusted investment; products or services that attract customers have potential to generate market rate returns. The majority of social enterprises, however, would like an adjusted component. This reflects the finding in the literature that most of the time there is a tension between impact and profit. An adjustment is important to enterprises selling goods or services to people on lower incomes, providing welfare services free of charge, and for those seeking to solve market failures. Four demand side interviewees expressly commented that a below market rate return was useful or necessary.	Investment [would only work] if there was a sliding scale of return... By that I mean, that there would be an understanding that the agreed return may be lower (Ākau). A loan from BNZ "accepting lower than commercial financial returns .... [is helping] Kilmarnock to become financially sustainable" (Kilmarnock). Dwell Housing Trust can service a debt, but it needs low interest loans: "low interest, or no interest would be brilliant" (Dwell Housing Trust). The market will not ever deliver affordable housing outcomes, it is designed to optimise yield. If you have a go at long-term sustainable intervention, there needs to be a subsidy somewhere in the value to chain to make it possible. (Paul Gilbert, New Zealand Housing Foundation).

***Table 2.2:** External finance needs expressed by demand side interviewees*

44 CEO, Friendship House.
45 Massey University, "Māori Enterprise Study Identifies Support Gaps."

While only a couple of demand side interviewees remarked that they need investors willing to take a risk, this need is implicit for any business seeking investment finance prior to the testing of their ideas in the market.[46] Even traditional businesses that are further along the development trajectory, and capable of generating market rate returns, can be risky investments. With social enterprises, the risk of investors making a financial loss could be greater, simply because social enterprises put impact before profit; in the current economic and regulatory framework the most impactful path is not necessarily the most lucrative. Ooooby, which is confident in its capacity to generate market-rate returns, made this point; if an opportunity arose "with a greater return to it" relative to an alternative path with less return and greater impact, it would choose the latter.

Bridget Hawkins, CEO of ReGen, sees the lack of risk capital in New Zealand as a major barrier to tackling problems that require urgent action:

> **"There needs to be a new culture of experimentation, we need investors willing to take a risk. This is how we get progress."**

Most supply side interviewees acknowledged that investments in social enterprises are riskier compared to for-profit businesses (which will most certainly follow the most lucrative path):

> **"You have to have investment from people or agencies or groups that are used to losing money... We [Christchurch City Council] have a different view, relative to commercial sector investment or lending, on risk and return... [It is ok if] the investment makes a lower return or exerts a higher level of risk because we believe in the social impact"**
>
> **– Raf Manji, Christchurch City Council Finance Spokesperson**

The conclusion that social enterprises need investors willing to take a risk aligns with Ingrid Burkett's research on the development journeys of social enterprises in Australia. She found that they do not mirror linear traditional business models; most were not sequential, "at times involving devolution, not just evolution.... [and] more than occasional crises of revenue".[47] Burkett attributes this "messiness" – and consequent higher investment risk – to the pursuit of multiple bottom lines. The key takeaway for investors and supportive intermediaries is to be careful in applying traditional business and financial models to social enterprises, as this may lead to unrealistic financial expectations.

Another problem with the application of traditional business models to social enterprises is that many are opposed to its end point and objective – scale. In the private sector, scale entails market competition, efficiency to maximise revenue and beating competitors out of the market to capture a greater share. While the pursuit of impact will require scale in many instances, for example solutions to mitigate carbon emissions, in others scale – and the "behaviour" it breeds – endangers progress.

Paul Gilberd from the New Zealand Housing Foundation commented, "the competitive mind-set is a fundamental barrier to impact"; it crowds out collaboration between organisations:

> **"For us, it is not about expansion and scale. In the ideal, I like to be able to label our products with quality assurance, and have 30 other businesses delivering it.... If you are driven by impact over profit, you do not need to dominate the sector or the market. It is more about networks – solving the problem with multiple actors – than scale."**

Part of the New Zealand Housing Foundation's mission is to create more integrated and mixed communities. This fits with its "big picture" approach to solving socio-economic problems. "Bumping into difference", mutual learning, cooperation, and building social capital are the ingredients of a strong civil society – in turn, the cornerstone of a well-functioning democracy.[48]

Too much efficiency, competition and big business have all been identified as "eroders" of civil society.[49] Social enterprises cite this erosion, as well conventional outcomes of scale (which include cutting wages, poor working conditions and ignoring environmental externalities), as drivers of a global movement against the traditional business model. The alternative is to stay small and build networks: plurality (over scale) is the end goal and impact is extended via cooperative networks (over competition), the logic being that local problems are complex and nuanced and require appropriately tailored solutions.[50]

46 Jamie Newth, Soul Capital (supply side interviewee).
47 Burkett, "Financing Social Enterprise Understanding Needs and Realities," 12.
48 Richard L Gage, ed., Choose Life: Arnold Toynbee and Daisaku Ikeda (London, England: Oxford University Press, 1989).
49 Anne-Marie Slaughter, "Thinking Big for Social Enterprise Can Mean Staying Small," Financial Times, April 23, 2018, https://www.ft.com/content/86061a82-46ce-11e8-8c77-ff51caedcde6.
50 Jennifer Aniyia Mara, Astrid &, "Zebras Fix What Unicorns Break," Jennifer, Mara, Astrid & Aniyia (blog), March 8, 2017, https://medium.com/@sexandstartups/zebrasfix-c467e55f9d96.

Gilberd was not alone in advocating for cooperation and building networks. Aroha Armstrong from Callaghan Innovation noted that they encounter social enterprise in this category:

> **"Many social enterprises are not looking to grow profit. They might want to feed the profit back into maximise impact to help more people or do more of the purpose stuff, but their purpose is not to scale and compete to be the next unicorn."[51]**

Other demand side interviewees expressed the need for new business models that prioritise impact:

> **"The mind-set to ten-x your revenue... gets brought into start-ups... but this kind of attitude can be damaging to the long-term impact of the business. There is need for a different mind-set, a different model the puts impact first, for social enterprises"**
>
> **– Dave Cameron, LearnCoach**

> **"For us, our purpose sits at the core of ReGen's financial strategy. This is opposed to a traditional business model; we have flipped the businesses model around and said we want impact to the wider community to come first – and this then informs our financial strategy. This is a more powerful way to approach it"**
>
> **– Bridget Hawkins, ReGen**

The *Te Manu Ka Rere: Fostering Māori Enterprise Financial Capability* report found that an alternative model is common in the Māori enterprise sector. According to one of the report's authors Dr Jason Mika, a cooperative approach to expanding impact is a characteristic that sets Māori enterprises apart from other businesses in New Zealand. This finding is in line with comments of interviewee Aroha Armstrong, Callaghan:

> **"People in Māori enterprise are uncomfortable about changing the way they do things to fit into a box; this risks taking away what they wanted to create in the first place..."**

Access to finance is affected for enterprises that choose to stay small and build networks because doing so compromises capacity to generate market-rate returns – which is what most providers of investment in New Zealand are seeking (this issue is discussed in the second part of this section).[52] Because of this, an adjusted component to the return expectation of an investment is often needed.

Adjusted returns, also referred to as concessionary returns, are financial returns below market-rate. Social enterprises often generate adjusted returns because impact is prioritised over financial performance. This leads to a financial return that is lower than normal, or adjusted, because of the additional outcome of social, cultural and/or environmental impact. In this report we have used adjusted rather than concessionary due to its more positive, intentional nature.

Adjusted returns will not always be necessary. Ooooby, for example, has found that there is a high demand for locally produced food and sees little tension between its mission, to put small-scale sustainable farming at the heart of our food system, and generating market-rate returns. However, a review of demand side interviews suggests that there is a tension in most cases, especially for enterprises providing welfare services. For example:

- The CEO of Skillwise, an organisation that helps people with disabilities to integrate and participate in their communities to enhance their quality of life, has "reservation[s] about... commodifying social problems". Individuals have complex needs and varying aspirations. Truly helping requires a tailored approach, time and resources; this can clash with the business logic of cutting input costs to increase profit margin.

- The CEO of Wise Group cautioned investors against seeking high returns because "generating money in this way takes the eye off the organisation's purpose and forces their energies into non-aligned activities; activities that aren't necessarily what these organisations are experts in."

- Paul Gilberd, New Zealand Housing Foundation, also commented that if "you're genuinely wanting to help the family to get into a home", this will compromise profit; "loading them up with a mortgage will not help... we are not trying to make money out of our money".

51 Interview with Aroha Armstrong, 25 October 2018
52 Ibid.
53 "Skoll | Skoll World Forum," accessed October 21, 2018, http://skoll.org/skoll-world-forum/.

Beyond welfare services, a tension could arise for other social enterprises that wish a product or service to be available to all consumers (including those on low incomes); this would likely entail reducing the price below market-rates.

Additional practical needs for adjusted capital include:

- **Tackling market failures:** Addressing market failures is not cheap; a grant or concessionary capital is necessary to subsidise projects – and can act as de-risking catalytic capital to attract more risk adverse investors.
- **Start-up, validation and growth capital:** If a social enterprise is unable to (or chooses not to) secure non-returnable finance, adjusted patient capital can play an important role for start-ups.
- **Adjusted returns acknowledges impact:** Can be viewed as a "fair exchange" for the "social or environmental return achieved" – John McCarthy, Tindall Foundation

A final and important point to be clear on is that financial returns do not reflect performance or impact. Indeed, there is evidence that the most impactful social enterprises do not generate market rate returns; it can take seven to 10 years to just break even, and during this time enterprises are reliant on grant and concessionary finance. Thus, for investment finance to meet the needs of the social enterprise sector, concessionary capital is a pivotal addition to mission aligned long-term risk capital.

IMPACT INVESTMENT: A SOLUTION TO THE FINANCE NEEDS OF SOCIAL ENTERPRISES

Because of constraints on both the demand and supply side, social enterprises are often excluded from mainstream financial markets.[54] In response to concern that the social enterprise sector is an "underserved market", so constraining its growth and innovation, impact investment was born to meet its unique capital needs:[55] mission aligned, long-term risk capital with (usually) an adjusted component.

What is impact investment?

Impact investment is defined by the Global Impact Investment Network (**GIIN**) as investments made with the intention of generating a positive social and environmental impact, alongside a financial return. Impact investors fall into two broad categories:

(i) Financial first investments are not willing to make any financial sacrifice to achieve their social goals.

(ii) Impact first investments are willing to make some financial sacrifice, by taking greater risks or accepting lower returns, to achieve their impact goals.

There is also general acceptance that any outcomes of an impact investment should be measurable.

Impact investment is recognised as the starting point from which to design financial instruments that meet the needs of social enterprises.[56] Because impact investing primarily changes the intention behind an investment (and therefore the structure of it), traditional investment instruments are similarly used in impact investing. Table 2.3 on pages 21 and 22 provides an overview of these, and how they may be structured to reflect the impact intention. Broadly, these instruments can be divided into two asset classes: debt and equity. These instruments can also be shaped to take the role of catalytic first loss capital. Investors providing first-loss finance are willing to take on greater financial risk (potentially loss) in return for driving toward target non-financial objectives. Given this characteristic, philanthropic finance providers (such as charitable trusts and foundations) are particularly well positioned to play the role of first-loss providers.

54 Ingrid Burkett, "Researching Underserved Markets: The Roles of Special Intermediaries in Australia" (Australia: Foresters Community Finance and Social Traders, 2013).
55 Ingrid Burkett, "Reaching Undeserved Markets: The Role of Specialist Financial Intermediaries in Australia" (Australia: Foresters Community Finance and Social Traders, 2013).
56 European Investment Bank, "Financial Instruments Working with Social Entrepreneurship" (Belgium: European Commission and European Investment Bank, 2016), 11.
57 Eva Varga and Malcolm Hayday, "A Recipe Book for Social Finance: A Practical Guide on Designing and Implementing Initiatives to Develop Social Finance Instruments and Markets" (Brussels: European Commission, 2016).

	Financial instrument	Explanation and implications for social enterprises
Catalytic First-loss and hybrid financial instruments	Debt	Can be used for long-term investments or project financing that promise stable and predictable cash flows over the next years. The stable and predictable cash flows are necessary as the debt capital providers receive an annual interest payment.
		• Annual interest payment require relatively low risk business model. • No dilution of ownership. • Period of repayment can be long-term and flexible. • High flexibility in use of finance.
	Guarantee	Written commitment to assume responsibility for all or part of a third party's debt or obligation or for the successful performance by that third party of its obligations if an event occurs which triggers such guarantee, such as a loan default
		• Beneficial for enterprise with little or no collateral. • No dilution of ownership. • Increases likelihood of investor investing (as decreases their risk)
	Quasi-Equity	Allows both the investor and investee to share the risk and reward, by structuring the instrument so that financial return is calculated as a percentage of the enterprises future revenue streams. If future expected financial performance is not achieved, a lower or possibly zero financial return is paid to the investor. Conversely, if performance is better than expected, a higher financial return may be payable. The instrument can be structured so that the return is capped.
		• More structurally complex than debt, but less costly than raising equity finance. • Helpful if an enterprise does not want to (or cannot) offer shares or if a loan is too risky. • No dilution of ownership; however, as repayment is tied to financial performance, investors may want more control (relative to debt). • Because of the greater risk, investors may seek higher returns.
	Social or Green Bonds	Private sector providers and investor(s) provide "upfront" capital for the realisation of a project (with verifiable and measurable social and/or environmental outcomes), which is repaid (typically by government) upon performance of that project. Typically, the Government contracts an intermediary to implement a project in exchange for a promise of payment, contingent on agreed outcomes delivered by the project. The intermediary will raise the capital for the project (by issuing bonds) from commercial and/or philanthropic investors. It will then contract a service provider to deliver the project's outcomes. If the project fails to deliver, the Government does not pay and the investors will lose part or all of their capital. If the project is successful, the Government pays the intermediary and investors.
		• Useful for financially constrained governments to extend welfare and environmental services. • Complicated and expensive to structure, but less so for projects with clear outcomes. • No dilution of ownership; however, as repayment is tied to financial performance, investors may want more control (relative to debt). • Places risk and pressure on enterprise to achieve outcomes. • Less flexible use of finance.

***Table 2.3:** Investment instruments identified as meeting the needs of social enterprises.*[57]

	Financial instrument	Explanation and implications for social enterprises
Debt financial instruments	Patient (or long-term) equity	Also known as long-term capital, the investor is willing to take more risk than traditional capital; takes a longer-term view (as there is no expectation of a quick return); and typically provides intensive support to grow the enterprise.
		• No obligation to service a debt. • Dilutes ownership; typically, impact investors receive control and voting rights. This can impact on enterprises culture a mission direction. • Benefit of long-term financial commitment. • Investors can be finance or impact (willing to accept below or zero market returns) first.
	Self-liquidating equity	A mechanism to build cooperate ownership over time. Instead of an Initial Public Offering, the exit strategy for shareholders is to sell shares back to the workers, who eventually buy the whole company back and become its owners.
		• Useful for enterprises that start-up in deprived communities to provide goods and/or welfare services. • Initial dilution of ownership. • Incentive for enterprise to succeed so they can buy back their enterprise.
Equity financial instruments	First-loss patient equity	Like patient equity. However, the investor has little (or no) expectation of return as is willing to make a loss.
		• Useful for start-ups, as no obligation to service and less (or no) obligation to pay dividends to the investor. • High flexibility in use of finance. • Dilutes ownership; typically, impact investors receive control and voting rights. This can impact on enterprises culture a mission direction. • Investor always impact first.
	Convertible Grant	The social investor provides the enterprise with a grant that is converted into equity or debt only in the case of success.
		• An inexpensive, low hassle financial instrument. • High flexibility in use of finance. • Useful if no equity available (can be converted into debt). • The investor covers financial risk, incentivises enterprise to innovate.
	Forgivable loan	A loan that is converted into a grant in the case of success. If the social enterprise reaches the goals agreed on beforehand by the investor and investee, the loan does not have to be repaid.
		• An inexpensive, low hassle financial instrument. • High flexibility in use of finance. • Enterprise bears full risk, but is strongly incentivised to achieve goals. • Useful if no equity available. • No dilution of ownership.
	Revenue share agreement	Financing instruments with which the investor finances a project and receives a share of future revenues. This risk sharing model can be used for the repayment of the financing and gives the social enterprise financial flexibility
		• An inexpensive, low hassle financial instrument. • High flexibility in use of finance. • High re-payment flexibility. • Useful if no equity available. • No dilution of ownership.

Table 2.3 (cont.): *Investment instruments identified as meeting the needs of social enterprises.*[57]

Table 2.3 demonstrates that finance is "enormously malleable… financial instruments can be moulded to meet the needs of social enterprises" for long-term, impact focused, risk capital, with a concessionary component.[58]

This malleability means that impact investment can be sought at all stages of a social enterprises development, from start-up to maturity, so greatly expanding the range of external finance options open to social enterprises. This is important to enterprises with an independence mind-set; some see grants and donations as "anathema" to their pursuit of self-sufficiency and efficiency.[59] They welcome the rigours of the market, the opportunity to grow, and thus seek investment finance from the outset. Typically, it takes a social enterprise 5-10 years from start-up to break even and start generating returns.[60]

Tailored financing

The most important point for investors seeking to meet the capital needs of social enterprises is tailoring. This is the process through which an investor finds the most suitable financial instrument (or combination of instruments) to support an enterprises impact orientated goals.

According to the European Venture Philanthropy Association (**EVPA**), for tailoring to be successful, finance providers "need to enter into a mind-set that puts the [social enterprise] at the centre of the decision, and adopts a deal-by-deal approach to build customised financial packages that fit with the needs of the investee, instead of offering a one-size-fits all solution".[61] EVPA also advises against starting off with an expected financial return as this increases the risk of distorting or minimising impact. Additionally, it risks creating an impact investment market that has "unrealistic expectations amongst [impact investors and investing organisations]".[62]

A better starting point is to commit to helping the enterprise achieve its impact, and to tailor returns accordingly. To this end, EVPA advises acknowledging the tension between financial return and impact, and to treat this as an adjustment when calculating risk adjusted financial returns. This means being ready to "sacrifice" some financial return for impact.

In an ideal impact investment market, there would be a range of providers offering a variety of financial instruments, as well as returns (market-rate, below market-rate, zero and negative). This is practical because it reflects the variety of social enterprise in New Zealand, in terms of their capacity to generate returns. Moreover, it is a necessity if social enterprises are to be a driver towards a more democratic and generative economy; they need investment that reflects their "reordering of priorities", so that profit is a means to serve people and the planet.

In the real world, impact investment is not serving the full variety of social enterprises

The benefits of impact investment for social enterprises seeking to achieve impact are obvious. To persuade the supply side to offer these services, however, has not been easy. A narrative has developed that investors can generate impact, alongside full market-rate returns. While this is accurate, it obscures that for most social enterprises "expecting both an extreme social impact… and a very high return… is not realistic".[63] Not only does this put the focus on the quality of the financial returns, but it risks missing the point that the primary purpose of a social enterprise is to generate impact.

The GIIN's annual Impact Investment Survey seeks to validate the market-rate returns narrative. In 2018, it reported that two-thirds of respondents target risk adjusted market-rate returns and that most investments have met their expectations for both impact (82%) and financial performance (76%).[64] In line with these findings the GIIN's website states, "Capitalism is tackling the world's biggest social and environmental problems – and giving investors a new way to do well by doing good".[65]

Claims to the affect that you can have your cake and eat it too are persuasive. However, they must be treated with caution. The GIIN Survey contains no commentary on the associated impacts achieved; relies on the performance of enterprises focused on financial inclusion (a sector that has received an estimated $20 billion in subsidies); and draws its conclusion from a small pool of funds (299), the overwhelming majority of which were targeting market-rate or close to market-rate returns.

58 Anake Goodall, Seed the Change
59 The Centre for Social Impact and The Ākina Foundation, "Part One: An Introduction to Impact Investment."
60 Gianoncelli and Boiardi, "Financing for Social Impact: The Key Role of Tailored Financing and Hybrid Financing."
61 Gianoncelli and Boiardi, 76.
62 Gianoncelli and Boiardi, 74.
63 Anna Guenther, CEO of PledgeMe.
64 Abhilash Mudaliar, Rachel Bass, and Hannah Dithrich, "Annual Impact Investor Survey 2018" (Global Impact Investing Network, June 2018), https://thegiin.org/research/publication/annualsurvey2018.
65 "Impact Investing | The GIIN," The Global Impact Investment Network, accessed September 14, 2018, https://thegiin.org/news/impact-investing-2.

For these reasons, critics raise the valid point that the current impact investment market (concentrated in the finance first space) is servicing only a thin pipeline of investable projects.[66] Moreover, that they are missing out the most impactful social enterprises – especially those that respond to demand from low-income communities for affordable and reliable goods and services:[67]

> **"... most [impact investment] funds – even those that talk about fighting poverty—bypass the more difficult, longer-term, and less financially lucrative investments that directly benefit the poor...".[68]**

This concern has been raised in the United Kingdom and Australia (both places which have a significantly more developed impact investment sector relative to New Zealand), and more broadly in a 2017 Oxfam Discussion Paper, Impact Investing: Who are we serving? This paper comments that the most impactful social enterprises in emerging and developed economies are likely to generate only "low-single-digit financial returns".[69] It also raises the point made earlier that financial returns do not reflect impact performance; although there is a strong desire from investors that financial gain and impact should be complementary, evidence from the social enterprise sector suggests that currently the two are "more often in tension than not".[70]

The main point to take away from these criticisms is that impact investment was supposed to be about serving the needs of social enterprises – especially those tackling complex social and environmental problems – but the returns that most impact investors are seeking has frustrated this end. Of consequence, impact investment has lost sight of what it started out to do and has become – to quote Bono (pop singer and philanthropist) at the Skoll World Forum on Social Entrepreneurship in April this year – an avenue "for good people to do bad deals".[71]

Even social enterprises with the capacity to generate market-rate returns complain that finance first investors do not meet their needs. At the Skoll World Forum, there were reports that profitable enterprises "bemoaned" the time and energy spent focusing on meeting the financial needs of investors, which could be better spent maximising impact.[72]

Internationally, impact investing appears to be at a crossroad. It could continue to be captured by the prevailing mentality of short-term profit maximisation, serving exceptional enterprises that do not sacrifice returns. Alternatively, impact investing could return to its original purpose by detaching itself from the old school, and refocusing on impact to serve the full pipeline of enterprises, and used as a tool to correct the world. The scale and urgency of challenges we are working to address demands the latter.

How is the fledgling impact investment sector evolving in New Zealand?

Many organisations or funds that focus on impact investment (for example, Soul Capital, The Impact Enterprise Fund and Enterprise Angels) seek market-rate returns. Jamie Newth, CEO of Soul Capital, commented that collectively, these investors "are only serving a narrow pipeline of enterprises...". This, he said, is the "most important point" to take away from the funding needs of social enterprises in New Zealand, "we are only meeting a small slither of the capital needs – the problem is the commercial models we are using, these are fine for commercial social enterprises but not for the full spectrum of social enterprise"

Newth's latter point raises a caution to investors about only applying traditional business and finance models to social enterprises. Some are opposed to a model prioritising scale and profit. Moreover, traditional business models can lead to unrealistic expectations around financial returns and does not meet the need for long-term committed capital.

Three supply side interviewees commented that new models and new thinking faces "structural barriers". Impact investment players with a background in commercial finance "bring their structures and their mental frames... they will not be able to genuinely do impact investment". [73] For this reason, Anake Goodall, CEO of Seed the Change commented:

> **"Most impact investing in New Zealand is coming from individuals. The organisations are failing to step up. It is individual human connections getting the work done at present. We hope that the work of these individuals will normalise impact investment."**

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66 M Bolis et al., "Impact Investing: Who Are We Serving? A Case of Mismatch between Supply and Demand" (Oxfam and Sumerian Partners, 2017); Sarah Dichter, Robert Katz, and Ashish Karamchandani, "Closing the Pioneer Gap (SSIR)," 2013, https://ssir.org/articles/entry/closing_the_pioneer_gap"Most investors, even those who care about impact, choose to avoid [high impact but low profitability enterprises]".

67 Chris West, "Can Impact Investing Both Solve Inequality and Bring High Returns?" Financial Times, September 24, 2018, https://www.ft.com/content/2236b95e-9998-11e8-88de-49c908b1f264.

68 Bolis et al., "Impact Investing: Who Are We Serving? A Case of Mismatch between Supply and Demand."

69 M Bolis and C West, "Marginalized Returns," Stanford Social Innovation Review, 2017, https://ssir.org/articles/entry/marginalized_returns.

70 Bolis et al., "Impact Investing: Who Are We Serving? A Case of Mismatch between Supply and Demand," 7.

71 "Skoll | Skoll World Forum."

72 Slaughter, "Thinking Big for Social Enterprise Can Mean Staying Small."

73 Jamie Newth, CEO Soul Capital.

The concern around structural barriers was supported by the views of supply side interviewees with a background in commercial finance. They saw little difference in the external finance needs between for-profit businesses and social enterprises, bar the fact that latter is less capable of generating returns. Indeed, one commented that social enterprises are not a good target for impact investment:

> **"I think we need to be careful about over emphasising the role of social enterprises in impact investment, in order to get returns quickly to investors and to build confidence in the [impact investment] sector"**
>
> **– Bill Murphy, Executive Director Enterprise Angels**

This interviewee to some extent reflects the views of other pioneers in the impact investment sector; the way to grow it in New Zealand is to have "wins" in the finance first impact investment space. As Sam Stubbs, CEO of Simplicity commented:

> **"Impact entrepreneurs need to be able to say: 'We will make you market returns and the social impact returns will be our comparative advantage, our impact is why consumers will buy our products and services and why we will be successful.'"**

This approach, however, has been trialled overseas, with the result that impact investment is becoming synonymous with finance first investment – thus leaving most social enterprises in the "under-served market" space. In New Zealand, organisational impact investors are doing the same. Soul Capital and the Impact Enterprise Fund, for example, have screened over one hundred enterprises for impact plus market rate returns; at the time of this report, Soul Capital had invested in three enterprises, and the Impact Enterprise Fund had invested in one enterprise.

The pioneers of impact investing in New Zealand acknowledge that their services alone are not adequate to meet the capital needs of social enterprise in New Zealand:

> **"I'd love to see impact investment funds sitting at the other end of the spectrum to market rate; that means funds recycling capital, loans with zero percent return"**
>
> **– Chris Simcock, Impact Ventures NZ**

This same interviewee suggested that the Philanthropic sector is best placed to deliver on this front. Indeed, trusts and foundations in New Zealand do not face the for-profit "thinking barrier".[74] However, how they use their money to do good is somewhat incongruous. Dividends are used to make grants; the bulk of their money (collectively estimated at $28 billion) is invested in low yielding bonds and portfolios (many of which are overseas, some fund dubious activities). There is great opportunity for this substantial pool of capital to mobilised and redirected into impact-orientated enterprises in New Zealand.

Out of the two philanthropic providers interviewed, one is already involved in impact investing (using its capital as opposed to dividends), the other "wants to get involved". Both are interested in impact first over finance first investment:

> **"There needs to be a values base to impact investment... we offer zero to market-rate returns, depending on the nature of the enterprise"**
>
> **– John McCarthy, Tindall Foundation**

> **"The interesting thing is what impact investment can do that other types of finance cannot... We're interested in the impact that different forms of finance can enable. We will weigh the potential impact and consider investments that have a risk profile too high for the mainstream, or that cannot pay the market-rate return. There is a need for long-term patient capital also"**
>
> **– Shona McElroy, Foundation North**

The sooner capital is mobilised to provide impact first investment options in New Zealand, the better. If we keep leaving impact investment to the commercial sector, it will shape how it develops. Jamie Newth drew attention to this point, "we have a somewhat perverse situation where the people with financial power derived from the status quo will define what impact investment becomes, despite it being a reaction to the status quo", this has already occurred overseas. To reclaim impact investment as a means to maximise impact in New Zealand, all supply side interviewees said that it must be "something new":

> **"We do not need the same kind of extractive models we have had in the last century. Impact investment should be something new... An investor should accept a lower return for impact. It is less about the individual, more about the community"**
>
> **– Anna Guenther, PledgeMe**

> **"Impact investing is not driven by profit, it's about community outcomes"**
>
> **– Teresa Tepania-Ashton, CEO Māori Women's Development Inc.**

74 Anake Goodall, Seed the Change.

"We need to seriously consider impact as part of the return for the investment. It's our primary purpose for investing, not an additional benefit on top of a market-rate financial return. That means being willing to accept financial returns lower than finance-first investors would accept. This is the only interesting way to do impact investment; otherwise you are not fundamentally doing anything that is different"

– Shona McElroy, Foundation North

McElroy also noted that she has recently been on a Winston Churchill travel fellowship – which confirmed for her that impact-first investment should be informing New Zealand's fledgling impact investment space:

"From the UK to the US, people said if you want to grow impact investment, you must challenge people about why they are investing. Finance will follow market-rate return opportunities without any fundamental shift – but impact-first investing opens up new opportunities for innovation and impact."

The *why* in impact investment is an important point; several demand and supply side interviewees commented that that it is about more than redirecting capital so that it adds values; it is also about challenging the way we think about money – when is enough, enough?

"If I could earn 3% a year than I'm happy with that and I am seeing this great stuff happening in my community. It is a win-win"

– Raf Manji, Christchurch City Council Finance Spokesperson

On this point about the purpose of impact investment, Jed Emerson, Founder of Blended Value wealth management group and author of the 2018 book "The Purpose of Capital: Elements of Impact, Financial Flows and Natural Being" presented a stark challenge to the SoCap conference in 2017:

"The purpose of capital is to advance a more progressively free and just experience of life for all; the purpose of capital is to negate, resist and challenge the present economic, social, environmental and political realities within which we now find ourselves."[75]

The desire for impact investment to be something new in New Zealand was expressed clearly by the demand side, who also expressed general discontent with the state of the sector. Table 2.4 provides an overview of concerns.

These comments add weight to the view that "it [was] not helpful to set out on the finance-first impact investment path". If impact investment is to be about helping the social enterprise sector to grow (as opposed to making the well-off more so), it needs to listen to the sector and refocus on impact.

General concern	Comments from interviewees
Impact investors are more concerned with profit	After six interactions with investment angels, we realised we didn't even want to touch them because of their values. They're completely driven by money (CEO, Kai). The term 'investment' means people only think about the financial aspect of it (Migrant Director, Migrant Action Trust). Part of me wants to believe that the impact has a value that gets positioned next to your business value. But my experience thus far is that when it comes to the crunch, impact falls away and it is all about the traditional business profit metrics. In fairness to these organisations, I would say this is because it is so new... There is great need for more investors committed to impact over the profit (Bridget Hawkins, ReGen). Finding impact-focused investors is difficult. If you are talking to the average angle investor – they are thinking in a commercial frame. They do not have the context to think about impact (Dave Cameron, LearnCoach).
Doubt that impact investment exists in New Zealand	I'm a bit cynical about this whole notion of social investment because to me it just seems like rhetoric really (CEO, Skillwise). [We] would shy away from individuals or organisations who are solely driven by profit and I know impact investment aims to bridge the two but it still comes down to 'show it to me' because I still haven't seen in that New Zealand (CEO, Kai). Aside from Soul Capital, we know of no other actual institutional impact investors... real impact investment is in only the form of high net worth individuals (Bridget Hawkins, ReGen).

***Table 2.4:** Discontent from the demand side about impact first investment.*

HOW DO SOCIAL ENTERPRISES IN NEW ZEALAND ACCESS FINANCE, WHAT BARRIERS HAVE BEEN IDENTIFIED?

THE FINANCIAL LANDSCAPE OF THE SOCIAL ENTERPRISE SECTOR IN NEW ZEALAND

This section draws on the existing primary research to answer: (i) types of finance the sector is using and where this is sourced from; (ii) barriers to accessing finance.

TYPES AND SOURCES OF CAPITAL FOR SOCIAL ENTERPRISES

Section One of this report identified that there are three broad sources of traditional capital in New Zealand: philanthropic trusts and foundations, commercial finance institutions (such as banks and angel investors) and Government (local and central).

Given that the capital needs of a social enterprise mirror their stage of development – so too does capital source. Because the start-up phase usually requires smaller amounts of money, self-funding, donations from friends and family, grants from philanthropic providers, or council grants are all options. As discussed above, grants are also important to more mature social enterprises seeking to address market failures. Table 3.1 on page 28 provides examples of the sources of non-returnable finance identified in the course of research for social enterprises in New Zealand.

75 Jed Emerson, Founder, Blended Value, "Reflections on Impact Resistance" Guest Post, SoCap 2017: https://socialcapitalmarkets.net/2017/10/reflections-on-impact-resistance/

Identified sources for non-returnable finance	Organisational finance providers
Individuals: Self-funding, donations from friends and family, or high-net worth individual on board with the idea.	
Philanthropy: Culpan and the CED report both found that most funding support comes from philanthropic organisations: trusts or foundations (including charitable family trusts); Statutory trusts and foundations (including community trusts and energy trusts); pub charities. Trusts and foundations are regionally divided in New Zealand. For a social enterprise to apply for a grant from a particular trust or foundation, its activities must be benefiting that provider's area.	Private trusts and foundations: • The Tindall foundation (commonly cited as the most helpful finance provider for social enterprises) • Vodafone New Zealand Foundation. • Todd Foundation • The Spark Foundation Community and energy trusts: • Foundation North • Rāta Foundation • WEL energy Trust
Central government: There is a widely held perception that the Government provides minimal financial support.	• Department of Internal Affairs: Community Organisation Grant Scheme (for NFP organisations to provide social services in communities) • Ministry of Youth and Development: Funding for community based support to young people • Ministry for the Environment: For fresh water projects, waste minimization, and more broadly "to make a positive difference to the environment"
Local government: As with central Government, support is limited, however some receive mention from social enterprises as helpful.	• The Auckland Council is a "progressive" supporter of social enterprise [76] • New Plymouth District Council • Christchurch City Council • Wellington Council
Crown settlements: Provide iwi with a source of redress capital that some use to provide opportunities for their members to start new ventures for the benefit of the community.	
Funding beyond Crown settlement for Māori enterprises	• Te Pūtahitanga o Te Waipounamu: A partnership between 9 iwi in the South Island to grow inspiration ideas that are whānau focused, intergenerational and provide direct impact for whānau • Government funding pools: Potama Trust and Te Puni Kōkiri
Rotary Clubs: Rotary is an international organisation that aims to bring together business and professional leaders in order to provide humanitarian service and to advance goodwill and peace around the world. In New Zealand, local clubs have started to recognise that social enterprises align with their mission, and so are proving grant funding.	• Rotary Club of Newmarket • Rotary Club of Wellington
Online fundraising platforms.	• Givealitte, managed by the Spark Foundation • GoFundMe, a US platform that can be used by New Zealanders to fundraise for anything
Private businesses: Social enterprises are interested in developing values-based collaborations and joint ventures with private sector businesses, which could involve grant based support.	

***Table 3.1:** Examples of sources of non-returnable finance in New Zealand.*

76 Culpan, "Social Enterprise Aotearoa - Insights and Opportunities," 60; "Our Projects (Old)," Auckland Microfinance Initiative, accessed September 13, 2018, https://www.aucklandmicrofinance.org/our-projectsold/"In partnership with Auckland Council's Community Development and Safety (CDS) team, AMI has undertaken three projects to help community groups and micro-entrepreneurs build the capabilities of social enterprise in Auckland's regional communities".

77 Gianoncelli and Boiardi, "Financing for Social Impact: The Key Role of Tailored Financing and Hybrid Financing."

Identified sources for impact investment: debt finance	Organisational finance providers
Commercial Banks: The CED Report notes that commercial lenders in New Zealand have not adequately met the needs of the social enterprise sector. This reflects the global phenomena discussed above whereby social enterprises are excluded from mainstream financial markets.	A social enterprise has successfully negotiated social loans with the BNZ, however found that they were "not impact investment literate". The International Financial Corp: Launched NZs first green bond in 2017: $100 million to finance private sector investment addressing climate change. Termed the Green Kauri Bond, it is managed by ANZ and BNZ.
Philanthropy: The CED Report found that Philanthropic finance providers (principally trusts and foundations) are the main sources of social loans in New Zealand. Nonetheless, this sector is only recently moving to diversity its funding model away from grants to investment.	• Tindall Foundation • Nelson Enterprise Loan Trust • The Southland Community Trust • The Rātā Foundation • Bay Trust • Foundation North: Looking to develop impact investing services.
Specialised social lenders: Of the CED report participants that sought investment, only 15% average came from specialised social lenders, suggesting that this sector is "The social lending space is sparsely populated and is fragmented".	• Prometheus Finance: Went into receivership in 2014, but was once the most "well-known" social lender in NZ • AWHI credit: Also in receivership • Microwise is one of New Zealand's oldest and well-known providers of unsecured, low interest loans to SME's and social enterprises
Crowdfunding: These online platforms enable enterprises to source soft loans from a collection of people who support their product or service. This support provides some security as to the success of the enterprises, and thus capacity to repay loans.	• PledgeMe • Kickstarter NZ
Friends and family: It is not uncommon for start-up enterprises in New Zealand to source seed funding in the form of soft loans from supportive family members and/or friends.	
High net worth individuals: Several demand side interviewees commented that they have been able to source impact investment from high net worth individuals.	
Social Bonds: New Zealand's first social bond is being trialled by the Government to help people with "mild to moderate mental health challenges" to find employment. It has successfully raised $1.5 million from the public sector, and the project is underway.	• The Ministry of Social Development is leading the mental health project; that bond is being delivered by APM Workcare
Local Government councils	• Christchurch City Council: Provides soft-loans • Auckland Council: The first council to issue green bonds. Successfully raised $200 million from its Green Bond share issue. The money will be used to buy more electric trains and equipment and refinance existing debt from electric trains
Private businesses: Social enterprises are interested in developing values-based collaborations and joint ventures with private sector businesses, which could involve grant based support.	

***Table 3.2:** Examples of sources of impact investment in New Zealand.*

Investment, in particular impact first impact investment, significantly broadens the capital options for social enterprises. In an ideal impact investment market, investment could be sought at all stages of a social enterprises development, and tailored to suit a social enterprise's individualised capital needs.[77] While the impact investment market is far from this ideal in New Zealand, a number of sources exist. Table 3.2 provides examples.

Identified sources for impact investment: equity finance	Organisational finance providers
Equity-based crowdfunding (as opposed to crowd-funding to raise donations or social loans) involves investors receiving company shares or other returns, depending on the success of the business.	• PledgeMe • Snowball Effect
Impact investment organisations and funds	• Acumen Fund • Root Cause • Soul Capital • New Ground Capital • The Impact Enterprise Fund
Angel Investors	• Enterprise Angels • Ice Angels, Angel HQ
Philanthropy	• Tindall Foundation: Has taken equity in the past, and looking to expand this service • Foundation North: Looking to develop impact investing services • Next Foundation, provides investment to education and environmental initiatives

Table 3.2 (cont.): *Examples of sources of impact investment in New Zealand.*

What types and sources of capital is the sector currently using?

The Department of Internal Affairs completed a mapping of social enterprises in 2012 . Despite the limitations of this mapping (it is likely bias towards more mature community enterprises and its data from 2012 is out-dated), it is the most comprehensive data set (in terms of the number of enterprises surveyed) available on the types and sources of capital currently used by the sector. Moreover, its results mirror the primary research undertaken for this report.

Table 3.3 shows sales, Government contracts and Grants are important revenue sources for social enterprises. These finding are consistent with more contemporary research on smaller cohorts of social enterprises including the CED Report published in 2014, as well as primary research.

Figure 3.4 shows the major external finance source for the 22 demand side interviewees; grants from the philanthropic sector and Government contracts were the most popular major sources (32% each).

78 Department of Internal Affairs, "Mapping social enterprises in New Zealand", 2013
79 Kaplan, "Growing the Next Generation of Social Entrepreneurs and Start Ups in New Zealand"; Culpan, "Social Enterprise Aotearoa - Insights and Opportunities."

Revenue sources	Average contribution to total income	Number using source
Trade via sale of goods or services	60%	346
Government contracts	59%	173
Revenue from investments or capital assets	11%	211
Contributions from parent or partner organisation	11%	30
Government grants	17%	69
Grants and donations (trusts, foundations and individuals)	18%	219
Debt finance	14%	24
External investors	23%	3
Other	13%	100

Table 3.3: *Percentage of revenue from different sources for social enterprises (Department of Internal Affairs Mapping, 2013).*

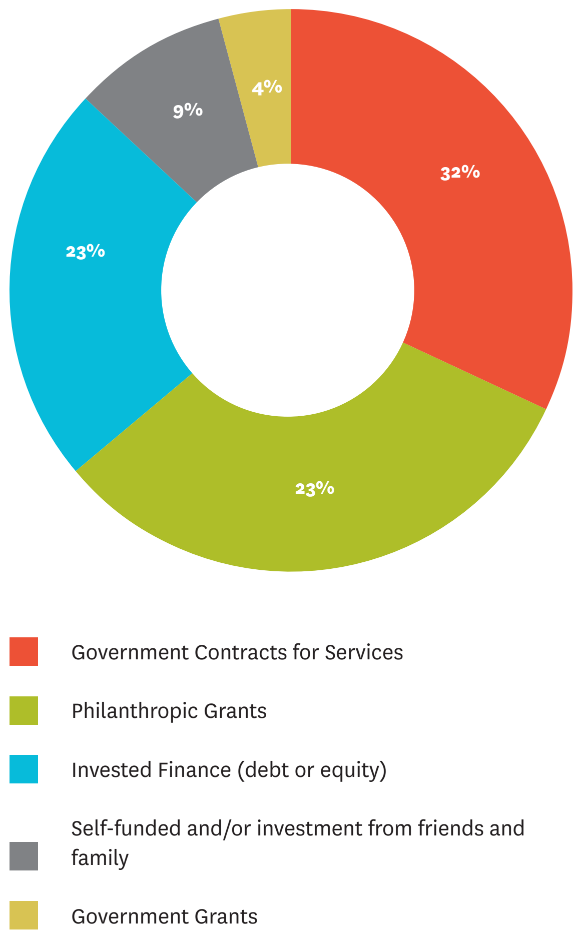

Figure 3.4: **The major external finance sources for the 23 social enterprises interviewed for this report.**

Supply side interviews identified four organisations that offer impact first investment, useful to social enterprises in their earlier stages of growth:

(i) **PledgeMe:** An online crowdfunding platform that provides debt[80] and equity crowdfunding finance options raised from supportive individuals. Often, the crowd will support the enterprises products or services (via purchasing them), thus proving a built-in guarantee against risk of failure. In this respect, crowdfunding is a "far more cooperative and social approach to raising finance" (Anna Guenther, CEO PledgeMe). The enterprise selects the rate or return, which can be in products.[81] PledgeMe estimates over half of its users are social enterprises.

(ii) **Seed the Change:** Supports seed initiatives to manifest a sustainable, equitable, and joyous world. CEO Anake Goodall said he is "most interested in sparks of ideas that could catch if they get a bit of oxygen" and provided capital at the pre-seed and seed stage.

(iii) **Māori Women's Development Inc. (MWDI):** A unique Indigenous financial institution formed by Māori women, controlled, managed and operated by Māori women, for the economic development of Māori women and their whānau. MWDI does not exclude any development stage from impact investment.

(iv) **The Tindall Foundation:** A private foundation that supports charitable organisations. Manager John McCarthy commented that the fact an organisation is not investment ready (in a conventional sense) "does not mean we walk away... If our Trustees believe in it, we are involved right in the early stages".

BARRIERS TO ACCESSING INVESTMENT

The research for this report identified numerous barriers to accessing each type of external finance (non-returnable, contracts for services and investment in the form of debt or equity). Before turning to outline the barriers under each finance type, it is worth drawing attention to two overarching barriers: a lack of understanding (resulting in a lack of supply) and legal structure.

Limited understanding equals limited supply of appropriate capital

The tension between traditional finance and social enterprise gives rise to an overarching barrier – a lack of conceptual understanding about what social enterprises are results in a supply side shortage of capital that meets the needs of social enterprises. This applies to each type of external finance because the suppliers of grants, contracts for services and investment have been "slow to accept the unfamiliar" (Anake Goodall, CEO Seed the Change).

Thus, the biggest barrier to accessing finance is quite simply that there is not enough of it. The majority of interviewees on the demand and supply side had strong views on this:

> **"There is very little money for social enterprise growth in New Zealand from a comparative perspective" [Comparing New Zealand to Scotland]**
>
> **– Shona McElroy, Foundation North**

> **"The finance options for social enterprises are sparse"**
>
> **– John McCarthy, Tindall Foundation**

> **"Access to capital is the major barrier to achieving more impact"**
>
> **– Paul Gilberd, Housing Foundation New Zealand**

Legal structure

"The funding worlds remain very binary between NFPs and traditional business; social enterprises have to choose which world to operate in" (Dave Cameron, LearnCoach). Choice, in this context, refers to the adoption of a legal structure (charity, incorporated society, or limited liability company), which in turn has implications for funding:

> **"If you elect a company structure, it becomes difficult to access funding from trusts and foundations"**
>
> **– Aroha Armstrong, Callaghan Investment**

This raises problems for early stage social enterprises with company structures that need grants. For enterprises registered as charities, grant funding may be easier in the earlier stages of development. Growth, however, requires larger capital injections and commercial finance providers are averse to loaning to charities (which are barred from taking equity). Social enterprises are working around these problems by adopting complex legal structures and creative lawyering, but this can be prohibitive at an early stage, and in all cases absorbs time and money that could be spent on impact.

Non-returnable finance

Several interviewees commented that grant funding from the trusts and foundations "is drying up" or "very tight" (CEO, Childfund). Previous research on the sector found that funding from central Government is "limited in scope" and offers only fragmented "pods of support".[82]

A supply shortage of non-returnable finance stems from a number of factors. Table 3.5 provides an overview:

80 Jennings, "Community Economic Development: Understanding the New Zealand Context."
81 Debt is important for charities barred from issuing shares.
82 For example, Cultivate has issued Broccoli Bonds: "people can either have 6% in cash and that's paid quarterly, or they can cash in on vegetable produce".

Barrier	From demand side	From Supply side
Not all grants meet the capital needs of social enterprises	Grants often fail to meet the needs of social enterprises because they have low flexibility of use, (see Section Two), and are too time consuming to apply for. "Philanthropists remain too risk adverse and this needs to change. For example, many grants remain single year grants rather than multiyear grants and this makes financial planning, stability and sustainability difficult to achieve (CEO, Inspiring Stories). "Due to the constraints government places on funding (tagged, auditing, process, the cost of compliance), the Wise Group has achieved their best results on things they've funded themselves because they're more ambitious with their targets and creative with their solutions" (CEO, Wise Group). These limitations of grants suggest that there are not enough grants that meet the "grant needs" of social enterprises.	
Not all grants meet the capital needs of social enterprises	"The main barrier is that will be failures. It is a reality that not every idea flies. There needs to be a new culture of experimentation. This is how we get progress. This is the biggest barrier – taking investment in a new way" (Bridget Hawkins, CEO ReGen).	"The government and finance providers need to adopt more of a risk model. We expect our enterprises to take these massive risks, but we are really risk adverse in terms of helping them.... we are too worried about the loss is something that needs to shift (Aroha Armstrong, Callaghan Investment)."
Power imbalance	"Instead of the Trust chasing money, we would like philanthropic organisations to chase us. Currently, there is a power imbalance... we're at the losing end because we're always the ones chasing money and the powers with them (Managing Director, Migrant Action Trust). "The Government has little appreciation for the environment enterprises operate in... there is little ability to negotiate" (CEO, Wise Group).	
Regional constraints		Trust and foundations in New Zealand are regionally divided. A lack of coordination between these regional grant providers has been identified as a barrier to mutual learning with regard to funding that meets the needs of social enterprise; "issue specific collaboration across regions is difficult" (Shona McElroy, Foundation North).

***Table 3.5:** Barriers to accessing non-returnable finance*

Central and Local Government contracts for services

Overseas evidence suggests that Government can play a proactive role in supporting the social enterprise sector by procuring their services.[83] However, in New Zealand, social enterprises generally cannot survive on contracts for services alone:

- "The volatility of government funding is seen as unhelpful" (CEO, National Building Financial Capacity Charitable Trust);
- When contract funding is tagged, it acts like a "straight-jacket";[84]
- Contracts do not permit the retention of surpluses, "[they] don't make us any money" (CEO, Childfund).
- The CEO of Wise Group commented, "Government contracts leave no margin for innovation, training, or inflation".
- Additionally, the practice of splitting contracts across organisations leads to duplicated efforts and is "grossly inefficient".
- The costs and time of tendering is high, as are compliance costs;[85]

Other barriers that the demand side noted included the fact that Government tendering process services favours larger, established service providers, "who can employ professionals to write tender documents" – thus crowding out opportunities for smaller providers. This finding is in line with the Productivity Commission's report, *More Effective Social Services*.[86]

Additionally, research identified a disconnection between the Government and the opportunities social enterprise provides. This finding was supported by interviewees:

> **"It has been slow going to get the Government to acknowledge that social enterprises are part of the solution"**
>
> **– Anake Goodall, Seed the Change**

> **"If you want to solve problems in communities, give it to the social enterprise sector to sort out.... They often have much more successful outcomes than the traditional top down approach... [but] they also work in a similar way to Government; they do look at the outcomes and they do get good value for money. Treasury should be supporting this stuff"**
>
> **– Raf Manji, Christchurch City Council Finance Spokesperson**

These comments support the observation in Culpan's 2015 report on the social enterprise sector; the lack of Government collaboration with social enterprises sits alongside an opportunity for it to better support the sector via public procurement. [87]

Commercial finance: debt and equity

The biggest deficit of understanding comes from commercial finance providers. More than one demand side interviewee (including those capable of generating market-rate returns) and one supply side interviewee said that they had to "dial back" the impact side of their enterprise to avoid "putting off" potential investors:

> **"During capital raising rounds, we cannot talk about our impact aspirations... We have to add emphasis to the money side of things to get investors on board"**
>
> **– Bridget Hawkins, CEO ReGen**

> **"If you are talking to the average angel investor – they are thinking in a commercial frame. They do not have the context to think about impact"**
>
> **– Dave Cameron, LearnCoach**

> **"After six interactions with investment angels, we realised we didn't even want to touch them because of their values. They're completely driven by money"**
>
> **– CEO, Kai**

In terms of accessing finance from commercial providers, several interviewees commented that this is a structural barrier:

> **"For commercial investors, there are structural barriers. They are less likely to invest if a business is not principally driven to maximise returns"**
>
> **– Anna Guenther, CEO PledgeMe**

It is also symptomatic of a false dichotomy held by finance providers that impact spells danger for financial returns. True, social enterprises can be high risk in their earlier stages of development, and require adjusted returns to get them to maturity. However, once an enterprise has proven it has a product or service that sells in the market, it is just as capable as a traditional business of serving a loan or paying dividends to shareholders.

The aversion of commercial finance to social enterprises has flow on barriers to social enterprises accessing capital. Table 3.6 provides an overview.

83 Jennings, "Community Economic Development: Understanding the New Zealand Context," 17; Culpan, "Social Enterprise Aotearoa - Insights and Opportunities."
84 Agapitova, Sanchez, and Tinsley, "Government Support to the Social Enterprise Sector: Comparative Review of Policy Frameworks and Tools."
85 Jennings, "Community Economic Development: Understanding the New Zealand Context."
86 Jennings, "Community Economic Development: Understanding the New Zealand Context.".. Productivity Commission, "Chapter 12: Better Purchasing and Contracting," in More Effective Social Services | Productivity Commission of New Zealand, 2015, 311, https://www.productivity.govt.nz/inquiry-content/2032?stage=4.
87 Culpan, "Social Enterprise Aotearoa - Insights and Opportunities."

Barrier	From demand side	From Supply side
Impact illiteracy on the supply side	The interviewees that have secured finance from a commercial provider described the process as "exceptionally difficult" or "quite a process". The CEO of Kilmarnock Enterprise commented that BNZ was "not impact investment literate" and "too risk adverse"; Dave Cameron, Learn Coach, said that "we have had to educate most of our investment group" about impact.	
Not serving enterprises with a long-term outlook	The Te Manu Ka Rere: Fostering Māori Enterprise Financial Capability report, found that financial institutions do not understand the needs of Māori enterprise for long-term capital; this is affecting access to external finance.[88] "Many Māori entities are looking at 50-100 years out and how their business will be sustainable and benefit future generations, whereas many mainstream small-to-medium sized businesses are more focused on the next 2-5 years. So financial institutions have to recognise the needs of their customers".[89] This barrier applies more broadly to social enterprises beyond the Māori economy with a long-term view.	"I think Māori enterprises are at the point where they have decided that the financial support structures are too difficult… This comes back to the risk aversion thing…. So we are going to go and do it ourselves by finding Māori investors" (Aroha Armstrong, Callaghan Innovation).
Commercial providers may not be willing to learn	"The main barrier is the banks who did not want to provide mortgages that did not look normal. They could not be bothered learning how to make it work, even though the rent to buy model has been around for years" (Paul Gilberd, Housing New Zealand). "If investors were educated about impact, this would mean less work for us…" (Dave Cameron, LearnCoach).	Anna Guenther, CEO PledgeMe commented that how to educate to get around structure barriers "is an interesting question".
Absence of collateral	"When we try to get money from the bank, we are selling the cash flow. We do not have any major assets to use as collateral… The bank looked at our capital base and they were not interested" (Steve Jukes, Pathways).	

Table 3.6: *Barriers to accessing commercial finance*

88 Wood and Mika, "Te Manu Ka Rere: Fostering Māori Enterprise Financial Capability."
89 Massey University, "Māori Enterprise Study Identifies Support Gaps:" Quoting Westpac NZ's head of specialists for Commercial, Corporate and Institutional Banking, Steve Atkinson.

Impact investing: Readiness of New Zealand

The main barriers to social enterprises accessing impact investment are threefold: A lack of impact first investors (supply problem); the related involvement of philanthropic trusts and foundations in impact investing; and capacity building to be investment ready.

Supply problem

There is a perception in New Zealand that "there are simply not enough social enterprises that are investment-ready ... the deficit is primarily on the demand side of the equation".[90] Indeed, the pioneering impact investors interviewed for this report commented that it was "a lot of hard work" to locate "investable enterprises".[91] However, as John McCarthy, Manager of the Tindall Foundation pointed out, the perception that few enterprises are investment ready "speaks to the maturity of the impact investment market in New Zealand", which is concentrated in the finance first space.

Bridget Hawkins, CEO of ReGen, noted that it has not been a smart move to set out on the finance first path. This has not only generated negative perceptions of impact investment on the demand side (see table 2.4), but has also overlooked the current state of the social enterprise sector in New Zealand; the majority of social enterprises are not capable of generating market-rate returns. The consequence is that there is "little available capital in the impact space for social enterprises in New Zealand" (Teresa Tepania-Ashton, Māori Women's Development Inc.).

Anna Guenther also thinks impact investment started out on the wrong foot, "it is supposed to be about growing early stage impact enterprises, who would otherwise not be able to source catalytic finance." This means investment with returns adjusted not only to reflect risk, but also the desire of both the enterprise and the investor to achieve impact (see Section Two).

Because of the underdeveloped impact first investment space, there is a shortage of investment capital on supply side. In other words, demand for impact investment is high, but providers are not meeting it. In support of this conclusion, Bridget Hawkins, CEO of ReGen, noted that the supply of impact investment is a "chicken and egg" situation:

> **"There are more purpose-led businesses today – we have seen them grow... But when you do not have impact investors to target, then you do not shake up your offering, so it is a chicken and egg thing. There is a need for actual impact first investment to drive demand also."**

Steve Jukes, Pathways, also commented in this vein. If the supply of capital served the sector's need, it will grow:

> **"We can only make the shift to more socially minded businesses if impact investment steps up its offerings to those enterprises that want to make a difference in their community or in their country, or environment, it can be driver for social enterprise in New Zealand."**

From the supply side's perspective, Shona McElroy from Foundation North commented that pioneering impact investors may struggle to understand the capital needs of social enterprises when they come from a commercial background: "those investors need to approach social enterprise investing with a learning mindset, it's not business as usual". Anna Guenther made a similar comment, impact investors with a commercial background need to be educated about the social enterprise model, but "to get over this structure barrier... would require a mind shift on their part from profit to impact." Jukes, along with all demand side interviewees that have managed to access impact investment, said that the process has been difficult, for example:

> **"It took 3 and a half years to find 1.2 million. There is no easy market to go to for impact investment.... there is no pathway to follow, no repository. If there were a platform to match wealthy people with impact enterprises, New Zealand would be a much better place"**
>
> **– Steve Jukes, Pathways**

> **"It is really difficult to find investors that look to the long-term"**
>
> **– Bridget Hawkins, CEO ReGen**

> **"Finding impact investors has been a really challenging process. At the start, we had a good business model, and the business grew fast in the market. But, the two years since – to get LearnCoach to the point of sustainable revenue, and investor ready – has been very tricky. We have had to learn how to articulate our mission to people. That process has been hard. When you are small, it is hard to get funding"**
>
> **– Dave Cameron, LearnCoach**

The lack of impact first impact investment in New Zealand has the interesting flow on effect that networks are hugely important in terms of access capital:

90 Kaplan, "Growing the Next Generation of Social Entrepreneurs and Start Ups in New Zealand," 41.
91 Chris Simcock, Impact Ventures NZ.

"It is networking that gets you access to finance; a lot of access to finance can come from who you know – being plugged into the sector is important"

– Bridget Hawkins, ReGen

"Finding investment is all about social networking – you need the networks to get funded. So I was lucky I knew a few people.... If I were cold coming in, that would be a big barrier. If you want to get funding, you have to be known and have evidence that it is working"

– Dave Cameron, LearnCoach

"There is a sense of momentum towards more people being interested in this idea of social enterprise... the networking thing is a huge"

– Managing Director, Ākau

In addition to these comments, two demand side interviewees noted that they are aware of high net worth individuals, from whom they hope to access funding. The flip side of these comments is that enterprises not "plugged in" to the sector face barriers to accessing impact first investment capital.

Most philanthropic trusts and foundations are not involved in impact investment

A common barrier to capital raised throughout the research was the involvement of philanthropy in impact investing. Internationally, this sector has been identified as best placed (along with governments) to offer impact first financial instruments. However, in New Zealand only a few were identified as offering impact investment (notably the Tindall and Rāta Foundations).

Traditionally, trusts and foundations invest their corpus funds for financial security/return only, and use the dividends to generate impact. The inconsistency of this is becoming increasingly discussed; as the social enterprise sector grows, so too does the ability to generate financial returns and impact from corpus funds. Four supply side interviewees commented that there is inconsistency in the funding model of Trust and Foundations, whereby they invest their capital in mostly overseas investment with moderate yields and use the dividends to make grants, for example:

"One thing that really gets on my goat is having to hear about foundations that are investing in Exxon Mobil because that maximises financial return – their logic being that they then have more money to help with climate change and biodiversity loss"

– Anake Goodall, CEO Seed the Change

"A massive responsibility is being missed by the trust and foundations. They should be investing their capital in New Zealand"

– Chris Simcock, Impact Ventures

According to Chris Simcock, there are two "major barriers" to the trusts and foundations using their corpus funds for impact investment: investment decisions are the domain of similarly-minded Fund Managers and risk averse boards, with John McCarthy of the Tindall Foundation noting that "colleagues in the philanthropic sector are very risk adverse".

Capacity building: financial

While the supply of impact first investment capital is certainly a primary barrier, this should not minimise the importance of support for ventures to become investment ready.

Anake Goodall, CEO of Seed the Change, has extensive experience working with social enterprise (in the past with Ākina and now as an impact investor). He commented, "the people we deal with are 90% social and 10% enterprise. They have big hearts, but some are financially irrational. They do not think about the finance side of things."

Many social enterprises are aware that they need support in this area:

"I think financial knowledge is a huge thing, and that's the one area even with Foundation North, CSI & Ākina, I still don't feel like I got the right support for that side of things, like fully understand the financial side of things"

– Research participant

"There is a large number of NFPs starting to think about social enterprise, but they do not know how to do it"

– Steve Jukes, Pathways

Demand side interviewees were asked for the "biggest enabler" for impact investment to work in New Zealand; four replied that greater support with income generating capacity is key.

For some enterprises, organisational cultural is an additional barrier to finance generation and investment readiness:

"[Investment] is an unusual space for non-profits who have been conditioned on phoning, ringing, writing and advertising to supporters and saying, 'give us more' and not 'invest more with us' so that's the challenge"

– CEO, Childfund

"On the boards of charitable trusts you will hear the word profit and think it is a bad thing. Work needs to be done to normalise the concept behind social enterprise, for people to see value in purpose and profit at the same time"

– Steve Jukes, Pathways

This cultural barrier rests on a philosophical opposition to profit generation. For example, the CEO of Skillwise noted that there is a "danger of commodifying social problems" by engaging impact investment because "private third party individuals will profit from work of social enterprise". One way to get around such opposition is to source impact investment from pools of funds used solely for impact.

Capacity building: measurement

The difficulties of measuring impact vary depending on the nature of the mission pursed by an enterprise. Generally speaking, when enterprises have greater control over variables related to outcome, it is much easier to design measurement methodologies and to report back to investors. When enterprises deal with human wellbeing, the degree of control over outcome lessens considerably.[92] For example, it is not possible to predict the number of people a programme targeting mental health will cure, nor causality. Thus, for social enterprises seeking to help individuals with complex needs, investors need to be flexible in their expectations around impact measurement and reporting.

Primary research revealed that the supply side needs financial and capability building support to design measurement methodologies and to report on these:

> **"The Ākina course was good in theory, but it does not work in practice. High levels of valuable resources would have to be delivered to developing measurements – that could otherwise be spent on programme delivery. I'd rather focus on the latter"**
>
> **– Steve Jukes, Pathways**

> **"It would be helpful if impact investment recognising the value of measurement – and provided funding for this aspect of the business"**
>
> **– Bridget Hawkins, CEO ReGen**

A final important point on measurement is for finance providers to be careful when tying outcomes to funding (as is popular in the social bond model). For enterprises will have less control over project outcomes or limited resources, earlier research has revealed that this can result in perverse outcomes:[93]

- When funding is received for successful results this incentivises taking "easy cases"; the avoidance of working with people who need support the most; and glossing over failures.
- Watering down the impact of an organisation is a risk when getting a certain number of people though a programme becomes a priority.
- Smaller underfunded organisations do not have the time, expertise or money to write reports proving their worth. This raises the concern that strict measurement and reporting requirements will crowd out grass-root providers in favour of larger organisations.

In light of these concerns, funding tied to outcomes is best suited to enterprises with a greater degree of control over the latter. New Zealand's first social bond did not take this on board:[94]

> **"The Wise Group was the first to go through the social bonds process [tendering for mental health services] but withdrew. We were very disappointed in general by the social bonds process. The initiative compromised trust in Government… We now have a limited interest in impact investment"**
>
> **– CEO, Wise Group**

> **"The Government did not pick the right sector [mental health] to trial bonds. Measuring the outcomes was way too complicated, and project overall expensive"**
>
> **– Raf Manji, Christchurch City Council Finance Spokesperson**

Manji stressed that for bonds to work (and to avoid the costs and complications associated with these financial instruments experienced overseas),[95] the Government needs to pick sectors where outcomes are easily measurable. If the Government did this, bonds have the potential to incentive impact investment in New Zealand; "things are easier in a smaller country". Manji's view on the possibility that social bonds could work in New Zealand was reflected by a number of interviewees on the supply side:

> **"I love the concept, it's about investing in outcomes. It's a great idea and fascinating for New Zealand"**
>
> **– Teresa Tepania-Ashton, CEO Māori Women's Development Inc**

> **"This Government, if it holds true to its potential will get very serious about social bonds. Pay for performance bonds – the commercial sector will respond to this"**
>
> **– Bill, Enterprise Angels**

> **"I have done a bit of research on bonds, and am aware that they can be complicated and expensive. Proper due diligence should be undertaken to identify where they could unlock impact"**
>
> **– Shona McElroy, Foundation North**

92 Garth Nowland-Foreman, "The Challenge of Accountability, the Opportunity of Responsibility for Third Sector Organisations" (International Society for Third Sector Research, Taipei, Taiwan, 2009).

93 Kate Frykberg, "Kate Frykberg Talks about the Fishhooks of Funding for Outcomes," What Works (blog), accessed November 7, 2018, http://whatworks.org.nz/nz-resources/kate-frykberg-fishhooks-in-funding-outcomes/.

94 The Treasury, "Social Bonds Information Release," Draft SOC paper on the first social bond, April 2017.

95 Peter Ramsden, "Social Impact Bonds: State of Play and Lessons Learnt," Working Paper (OECD, 2016); Stellina Galitopoulou and Antonella Noya, "Understanding Social Impact Bonds," Working Paper (OECD, 2016).

Paul Gilberd from the New Zealand Housing Foundation noted that he has been working with New Ground Capital for the past 18 months to design a "housing impact fund government backed bond product to get some scale into this market". ANZ has already agreed to fund the project, "the missing piece of the puzzle is the Government to act as guarantor." Gilberd said that were the Government to pull through on this front, housing bonds would be "game changing" in terms of the Housing Foundation's capacity to get more low-income families into affordable and sustainable housing.

In relation to developing an impact investment market that serves the full spectrum of social enterprises (meeting a range of capital needs), interviewees raised other issues, or barriers. Table 3.7 provides an overview of these.

Barrier to growing impact investment	From demand side	From Supply side
The Government is not sufficiently involved	Several commented that the Government should be more active in the impact investment space: "The Government does not invest for impact… and traditional capital markets do not understand the social enterprise model. There is need for greater understanding and long-term capital providers in the public and private sectors" (Bridget Hawkins, ReGen). "I'm hoping we'll be able to leverage a stronger relationship with Government where they see [our enterprise] as an impact investment piece themselves" (CEO Kilmarnock Enterprises). All interviewees were asked for their thoughts on a Government impact investment fund, the majority (15 out of 20) answered yes, provided the fund is impact first. The Wise Group also made the valuable point that the fund should be informed by the "community of practice" that has developed overseas in this area.	Raf Manji, Christchurch City Council, noted that the Government should be playing a more active role in impact investment; if an enterprise has the potential to help policy agenda, it should be picking winners. Manji referenced the work of Mariana Mazzucato on the entrepreneurial state.
The Government is too risk adverse to engage in impact investment	The CEO of Dwell Housing Trust was "cynical" about a Government impact investment fund; they are "too risk adverse… whenever Government gets involved in anything it makes it so much more complicated".	"The Government does not have the risk mind-set or the capacity to do impact investment" (Anake Goodall, Seed the Change).
Regional division		"The majority of trusts and foundations are too regionally focused." (Chris Simcock, Impact Ventures). This is a barrier to mutual learning and discussion between trusts and providers on best practice for impact first investment.

***Table 3.7:** Barriers to developing an impact investment market accessible to the full range of social enterprises.*

WHAT ARE THE CAPITAL NEEDS OF SOCIAL ENTERPRISES IN NEW ZEALAND AND CAN IMPACT INVESTMENT MEET THEM?

RECOMMENDATIONS

1 There is a significant lack of 'impact first' capital in New Zealand. Investors in the position to make impact first investments should consider how they can integrate these into their portfolio. A balance of capital (finance first, impact first and mixed) is a prerequisite for a flourishing and genuine social enterprise sector. In doing so it should be ensured that any barriers to impact investing are actual rather than perceived.

2 Philanthropic organisations to help accelerate development of the social enterprise sector by de-risking impact investments.

3 Government to consider how it can create an enabling environment for private led impact investing. Supporting the National Advisory Board Aotearoa New Zealand and its efforts is fundamental to this.

BARRIERS TO REMOVE

Changes which will remove some of the key barriers to impact investing that exist currently:

4 Clarify fiduciary obligations of community trusts and foundations. The prevalent belief that those holding funds must only invest their corpus for maximum financial return is hindering impact focused organisations from participating in impact investing. The intent of legislation relevant to these points should be clarified.

5 Consider how existing legal structures create barriers to accessing capital for social enterprises, and how these barriers can be removed.

SOLUTIONS TO IMPROVE

New initiatives which would assist in creating an enabling environment for private led impact investing:

6 Consider initiatives to develop impact investing capability for both supply and demand sides of the impact investing market.

7 Consider a government-backed fund for impact investment. This could include government guarantees for impact investment, social impact bonds and specific investment instruments.

8 Review international success of social impact bonds, including the sectors they've proven to be effective in, and explore implementing similar bonds in New Zealand.

9 Consider other ways to incentivise private led impact investing, including applying the French 90/10 model to Kiwisaver investments, or a tax incentive for impact oriented investments.

Considerations for these recommendations:

1. BARRIERS TO ACCESSING INVESTMENT

- The ability to undertake impact investments should be considered by investors and organisations pragmatically, rather than avoided due to risk aversion or recency.
- The risk and return of an individual impact investment should be assessed by investors as any other investments would be, rather than being presumed too challenging.
- If an investor has lower return investments in its portfolio already, it should consider how these can be transitioned to impact first investments.
- Investors would benefit from undertaking capability building if they are not confident in understanding organisations impact.
- Foundations, Philanthropists and Government are natural leaders in this area.

2. PHILANTHROPY TO MORE ACTIVELY DE-RISK IMPACT INVESTMENTS

- By making investments more aligned to their purpose, philanthropy can take a higher risk position in deals to enable private investors to then come in at risk levels that suit them.
- This can be through managed funds, bonds, or first loss positions within individual investments.
- The Social Enterprise Development and Investment Fund in Australia is a model to consider here.

3. GOVERNMENT SHOULD CONSIDER HOW IT CAN CREATE AN ENABLING ENVIRONMENT FOR PRIVATE LED IMPACT INVESTING AND SUPPORT THE NATIONAL ADVISORY BOARD AOTEAROA NEW ZEALAND

- This would involve a number of short term actions that would cumulatively enable the private sector to continue impact investing and growing impact without ongoing Government intervention.
- Formalise an explicit Government lead on impact investment. This should include both a lead agency and an appointed Minister, individual, or team with the appropriate seniority and expertise.
- Resource the National Advisory Board Aotearoa New Zealand to enable it to support New Zealand's impact investing ecosystem. The recently released report by Pure Advantage, Financing the Future, also strongly emphasises this. We recommend this report is read also.

4. CLARIFY FIDUCIARY OBLIGATIONS OF COMMUNITY TRUSTS AND FOUNDATIONS

- We recommend changes are considered for New Zealand legislation similar to those introduced in the UK through the Charities (Protection and Social Investment) Act 2016.
- We note that related changes are currently before the Committee of the whole House as part of the Trustee Amendment Bill, but question whether these amendments will sufficiently clarify that investments can be made primarily for the purpose of the trust.
- We also recommend other legislation relevant to how trusts operate (including Charitable Trusts Act 1957 and Community Trusts Act 1999) should be similarly reviewed to ensure no ambiguity remains.
- Specific attention to this point should also be given within the announced upcoming review of the Charities Act 2005.

5. CONSIDER HOW BARRIERS TO CAPITAL CREATED BY LEGAL STRUCTURES CAN BE REMOVED

- Social enterprises spoken to within this research felt that existing legal structures hindered their hybrid nature.
- Ākina is currently completing research, following conversations with the Ministry of Business, Innovation and Employment, to understand whether existing legal structures do create any barriers or disadvantages for social enterprises. This is due for completion in February 2019.
- If that report does identify barriers, further engagement with the sector will be necessary to explore appropriate solutions for New Zealand in order to make informed recommendations to Government.

6. DEVELOP IMPACT INVESTMENT CAPABILITY FOR BOTH SUPPLY AND DEMAND SIDES

- On the supply side, the key area where capability needs to be increased is around understanding impact measurement and management, and on the demand side the key area is capital strategy – understanding how investment could support the goals of their organisation.
- Support the development of a repository of tools and resources related to impact investment, navigating the deal-creation process, and the sharing of success stories.
- Provide support for specialised intermediaries who can support social impact organisations to secure and deploy impact investment, building capability of both sides of the market in the process.
- Investigate the extent to which impact measures could be standardised across grants / contracts and impact investment for consistency between Government agencies and social impact organisations.

7. GOVERNMENT TO CONSIDER A FUND FOR IMPACT INVESTMENT

- Target fund returns to be 'impact first' and/or 'mixed motive'.
- Plan to establish a fund as an independent or 'arm's length' entity from Government, with Government retaining influence on high-level focus and strategy but separate from all aspects of the fund's management and investment decision making.
- Consider dedicating some of the fund to innovation. This may lead to the creation of more robust and effective product and services, and more sustainable business models and therefore perform a connected and supporting (but separate) function, to the broader fund.
- Consider the fund being 1) specifically focused on social impact (to not duplicate the Green Investment Fund), 2) evergreen (indefinite in duration while providing greater liquidity options for private investors), and/or 3) closed loop (where Government's initial investment is recycled/reinvested over the duration of the fund to build the overall capital base).
- Understand the establishment of a fund is a strategy to create an enabling environment for private sector led impact investing – creating confidence, learning, and prototyping opportunities (i.e. in impact measurement and reporting approaches), and precedents for the private sector to then continue.
- Consider how such a fund could contribute to the identified capital gap between angel investment and next stages.
- Ensure capability support, either directly or through associated partners, is part of any fund.
- Consider the development of 'Impact Certification' for organisations as a means to help investors, funders, and buyers to identify potential impact investment partners, as well as ensure the impact credentials of organisations.
- Ensure that the fund design and strategy is co-designed with all stakeholders (supply and demand).
- The Australian Social Enterprise Development Investment Fund is a model to consider.

8. GOVERNMENT TO REEXAMINE INTERNATIONAL SUCCESS OF SOCIAL IMPACT BONDS

- The Peterborough Social Impact Bond was the first social impact bond, in 2010. It focused on reducing reoffending rates of young released prisoners, and successfully did so beyond targeted rates.
- There are over 100 social Impact bonds in over 25 countries, generally focusing on similar impact areas.
- The first social impact bond in Australia was the Newpin Bond, which restored children in out-of-home care to their families. This has been successful so far, delivering strong outcomes and therefore strong financial returns.
- Australia has a number of bonds in market now, predominantly focusing on at risk young people.
- Consider outcomes which are easily measurable (i.e. a child rehomed).

9. GOVERNMENT TO CONSIDER OTHER WAYS TO INCENTIVISE PRIVATE LED IMPACT INVESTING

- Investment of KiwiSaver funds is a significant opportunity for impact, and there is strong public opinion that these funds should be invested responsibly. The French 90/10 model is one successful example to encourage this.
- It is important to increase the level of private capital going towards impact, and reducing tax on these investments is one way this has been done overseas.
- The UK model provides a 30% tax break for investments into social enterprises through the Social Investment Tax Relief scheme, incentivizing investors to invest in impact.
- Consider appropriate limitations, including investment caps which genuinely incentivise institutional investors, rather than discouraging with small caps as occurred initially in the UK.

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APPENDIX

Interviews conducted by Authors

1. Aroha Armstrong, Group Manager, Māori Economy, Callaghan Innovation
2. Dave Cameron, CEO, LearnCoach
3. Paul Gilberd, General Manager, NZ Housing Foundation
4. Anake Goodall, CEO, Seed the Change
5. Anna Guenther, CEO, PledgeMe
6. Bridget Hawkins, CEO, Regen
7. Kerensa Johnston, Chief Executive, Wakatū Incorporation
8. Steve Jukes, Executive Director, Pathways
9. Raf Manji, Christchurch City Council Finance Spokesperson
10. John McCarthy, Manager, Tindall Foundation
11. Shona McElroy, Innovation Catalyst, Foundation North
12. Bill Murphy, Executive Director, Enterprise Angels
13. Jamie Newth, Chief Executive, Soul Capital
14. Chris Simcock, Director, Impact Ventures
15. Teresa Tepania-Ashton, CEO, Māori Women's Development Inc.

Interviews conducted by Ākina

16. CEO, Wise Group
17. Chairwoman, Te Kaika
18. CEO, Kai
19. CEO, Kilmarnock Enterprises
20. CEO, Skillwise
21. Co-Founder, Cultivate
22. CEO, Childfund
23. Manager, Kaipatiki
24. CEO, Ooooby
25. CEO, National Building Financial Capability Charitable Trust
26. Chairperson, Project Lyttleton
27. Managing Director, Ākau
28. Managing Director, Migrant Action Trust
29. CEO, Friendship House
30. Managing Director, Loomio
31. Manager, Te Hou Ora Whanua Services
32. CEO, Inspiring Stories
33. CEO, Dwell Housing Trust