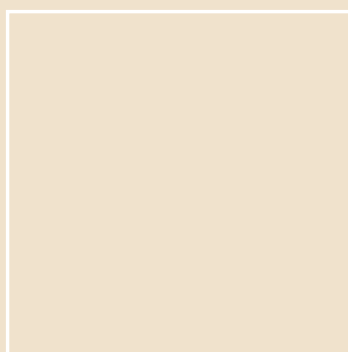
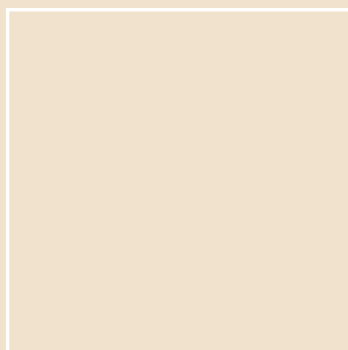
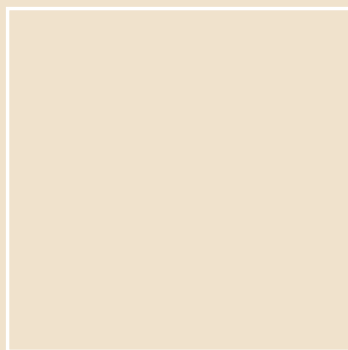


Developing a Social Equity Capital Market 2006

Page index

	Page
Foreword	4
Introduction from the Steering Group	5
Steering Group Members	7
Developing a Social Equity Capital Market	9
Introduction	15
Research Method	18
Interview Findings	19
Key Issues	34
Appendix	45



Foreword



Identifying and raising new sources of equity capital is a challenge for any new start up, or growing business when the primary driver is generating maximum return. For the growing number of social entrepreneurs and social investors, the opportunity to invest in a social enterprise that has the potential to generate both financial and social returns, ought to be an attractive proposition. But how do we draw attention to the opportunities these social enterprises offer investors? How do we create maximum opportunity to raise equity capital and free social enterprises from the cycle of reliance on grant and statutory funding?

It was these very questions and debate that led the Charities Aid Foundation (CAF) to commission **nef** (the new economics foundation) to undertake this piece of research. This report explores whether the solution lies in better utilising existing mechanisms or, given the rapid growth and increasingly significant role played by these social enterprises, questioning whether the time is right to consider an alternative, a 'social stock exchange'.

CAF has a history in being an innovator and pioneer in creating new financial mechanisms to support the development, wealth and strength of the charitable sector. We have been delighted to work with **nef** and the wider steering group to develop this early stage research. A key outcome of this report has been to engage with other actors in the social investment sector, to foster a debate about the role of equity listing for social enterprises. Indeed, we look forward to working with partners to create solutions which have the potential to unlock new sources of equity capital for social enterprises.

Particular commendation should go to Jessica Brown in the Access to Finance Team at **nef** who undertook the research and completed the report. Working alongside **nef** has been an active group of financial practitioners – our Steering Group – actively chaired by Mark Campanale from Henderson, with representatives from the London Stock Exchange, CAF, Triodos Bank, the Global Exchange for Social Investment (GEXSI), P3 Capital and Catalyst Fund Management. Thanks are also due to all the senior executives of social purpose business who kindly agreed to be interviewed for this report.

Tracey L Reddings
Chief Executive, CAF Bank Ltd

Introduction from the Steering Group

Traditionally, stock exchanges have been the arena for uniting entrepreneurs and investors. By tapping a broad pool of capital, businesses are able to gain the resources to develop and grow. Some things are lost in the listing process, however, not least corporate independence. And there is growing awareness that a company's wider social mission can also be threatened by becoming a publicly listed company. This ground-breaking study undertaken by **nef** (the new economics foundation) and generously funded by the Charities Aid Foundation (CAF) seeks to find practical measures to overcome this challenge, by developing capital markets that can serve social entrepreneurs.

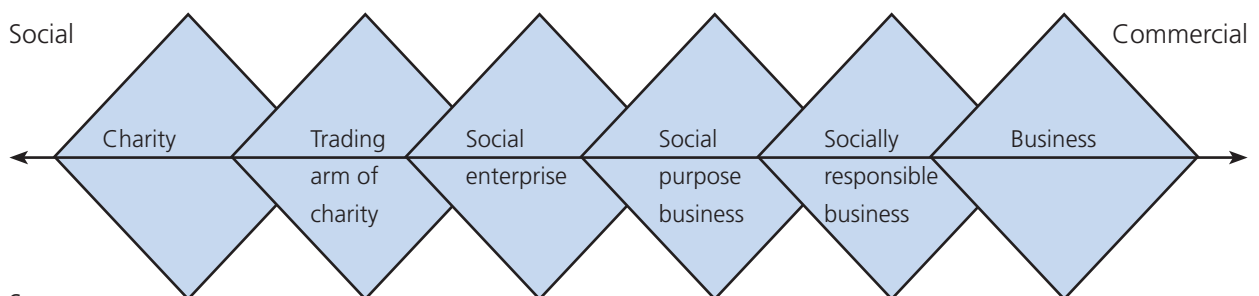
This study comes at an opportune moment. Early in 2003, the Bank of England's Domestic Finance Division issued a report entitled 'The Financing of Social Enterprises' which noted that share issues may "gain in popularity over the next few years if social enterprises reach the size necessary to launch them". This prediction has been borne out in practice with some high-profile alternative public offerings (APOs) taking place since then, such as Cafédirect and Traidcraft. Estimates suggest that there are now some 55,000 social enterprises in the UK that are growing their turnover, evolving their businesses and starting to look to the markets for equity financing. Alongside this, there is some £6 billion of funds invested by specialist socially responsible investment funds and £40 billion of charity and foundation money, seeking companies with social value. It is time to link the two.

This study has provided answers to some critical questions. How prepared are these markets to address the needs of social entrepreneurs? To what extent are brokers able to capture social value when preparing Initial Public Offerings? As the Bank of England report cautions, the stock markets "may undermine the social objectives of the original owners of the social enterprise." And how do brokers and social entrepreneurs interact with the other critical group in this equation, investors, when it comes to focus on the delivery of both financial and social returns? Importantly, the report also examines the needs of potential investors, notably the ability of companies to adapt to the increased scrutiny of public markets.

This study is the first to seek out the perspectives of the critical stakeholders, interviewing entrepreneurs, investors and financial intermediaries. Not surprisingly, this has unearthed continuing expectation gaps between social entrepreneurs and equity investors.

Ultimately, what has emerged from this intensive analysis are a set of forward-looking recommendations for closing these gaps. These include exploring partnerships with mainstream markets; establishing a common information point; and supporting business in raising equity capital. Importantly, the report mirrors one conclusion from The Bank of England report on "Financing Social Enterprises" namely that over the longer term, as the extent of share issuance increases from this sector "there may be the opportunity for the sector to develop a more substantial secondary market." Essentially, a social stock exchange that's fit for the needs of the sector. The government could support this process through fiscal incentives that combine the best parts of venture capital trust (VCT) structures and enterprise investment schemes (EIS) with community investment tax relief (CITR).

To be clear about the place of a social purpose business along the spectrum of enterprises, the graphic below indicates that social purpose businesses fall roughly at the mid-point between social and commercial objectives. These businesses are likely to have experienced some form of early stage investment, whether through debt or equity, and be generating some profit. The intention of a social equity capital market is to assist social purpose businesses to access equity capital without needing to progress to a commercial structure that emphasizes profit maximisation. The spectrum below highlights the place of social purpose businesses in relation to other organizational forms.



Source:
John Kingston, Venturesome

We hope that this report brings together a better understanding of the social capital conundrum – and also inspires many more to join the search for solutions.

Steering Group

Steering Group Members

Mark Campanale, (Chair)	Head, SRI Business Development Henderson Global Investors
Tracey Reddings	Executive Director, Charity Financial Services Division, Charities Aid Foundation (CAF), Chief Executive CAF BANK Ltd & CAF Marketing Services
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Pradeep Jethi	Formerly New Product Development Manager, London Stock Exchange
Charlie O'Malley	Partner, P3 Capital
Rod Schwartz	Chief Executive, Catalyst Fund Management & Research Ltd
Sharon Stearnes	Formerly Executive Director of Philanthropy Services, Charities Aid Foundation (CAF)

Developing a social equity capital market

Developing a social equity capital market

Executive summary

The rise of social entrepreneurship has resulted in an increasing number of businesses seeking to maximise both social and financial returns. Like traditional businesses, these organisations need equity capital to grow and achieve their strategic objectives. With an estimated 55,000 social enterprises in the UK, it is clear that many of these new businesses will require equity finance as they evolve.

Businesses set up for a social purpose operate across a range of sectors, but have a common objective: to generate a reasonable profit whilst providing goods or services creating social benefit.

Social purpose businesses may seek to expand operations. As they do so they are likely to require funds beyond bank borrowing or early stage investment. Issuing shares in the company through an equity listing is a route to raise significant capital. This builds the number of stakeholders, offers an exit for early stage investors and provides a basis for future investment.

Social purpose businesses have issued equity in various ways. The London Stock Exchange (LSE), Alternative Investment Market (AIM) or PLUS Markets represent established sources of available capital. However, some have chosen to avoid the mainstream markets and opted for an unlisted or alternative equity offering instead. The experience of equity listing raises questions about the barriers, challenges and opportunities that social purpose businesses face in this process.

What is the best way to direct equity capital to social purpose businesses? Are existing equity capital markets sufficient to meet the needs of social purpose businesses, and if not, does this suggest an alternative market mechanism is required?

These questions form the basis of research carried out by **nef** (the new economics foundation) in conjunction with the CAF (Charities Aid Foundation) to capture the views of key representatives from the UK social investment sector. The purpose of this report is to focus on the challenges that equity listing raises for social purpose businesses, and explore issues related to developing a social equity capital market.

Key findings

Our research with social purpose businesses looking to raise funds indicates that they have important requirements of the equity listing process, including:

- an ability to maintain ownership
- desire to attract investors with a long term perspective
- limitation of speculation in the capital market
- control over social mission
- investors with understanding of social as well as financial return

Likewise, investors seeking a social investment opportunity require:

- regular reporting and disclosure
- liquidity of shares
- independent mechanism for valuation
- clarity of financial and social return expectations
- a market with FSA regulated status

As social purpose businesses continue to expand, it is clear that a market mechanism to raise and trade in equity capital would bring benefits for owners, entrepreneurs and investors alike. The success of unlisted equity offerings with individual investors demonstrates demand for social investment alternatives; whilst charitable foundations have only just begun to explore investment related to their social missions.

The solution could be a social equity capital market in the form of an index, designated classification or registered group that is part of an established exchange. Alternatively it may be possible to expand existing trading mechanisms such as Internet-based exchanges or matched bargain market.

The interviews carried out indicate that, in general, there is positive support for such a mechanism. Yet most are cautious about the practicalities that must be addressed. Social entrepreneurs were the most enthusiastic about the concept, whilst SRI fund managers the most sceptical. A range of practical requirements of a social equity capital market were identified:

- regular reporting and transparency
- minimisation of speculation
- limitation on ownership and takeover
- a critical mass of investment-ready social purpose businesses
- investment intermediaries and advisers for the social sector

- accreditation process
- equity research coverage
- social audit process
- nominated advisers to support equity offers and carry out due diligence
- enhanced investor awareness of social investment alternatives

Next steps

Establish a common information point

Create an online forum to bring together the range of information and initiatives involved in providing equity capital to social purpose businesses. *Objective – raise investor awareness of social investment opportunities and greater understanding of equity listing as an option for social purpose businesses.*

Develop social equity capital market prototype

Develop a feasibility study and business plan for a market mechanism to raise and trade equity capital. *Objective – establish a framework to begin resolving practical issues and enable solutions to structure, location, cost and accreditation to be found.*

Explore partnerships and alternative market mechanisms

Discuss possible partnerships with mainstream markets such as AIM or PLUS Markets or internet-based ShareMark and Early Stage Investment Exchange. *Objective – explore how a social capital equity market could be established by partnering with an existing exchange.*

Build links with ethical investors

Individual investors often form the majority of shareholders in unlisted social purpose businesses. These investors are often drawn from the consumers, employees, suppliers or community members who actively support the social mission of a company. Explore how to build links with and develop a formal network of these individuals. *Objective – expand the awareness and interest in investing in social purpose businesses.*

Support social purpose businesses to raise equity capital

Help prepare social purpose businesses for market by initiating programmes of technical assistance and investment support. *Objective – increase the number of ‘investment-ready’ social purpose businesses equipped to enter the equity capital market.*

Develop investment intermediaries

Identify specialist advisers who can play a key role in the social purpose business market by acting as intermediaries and assuming responsibility for due diligence and accreditation. *Objective – ensure a robust market develops by providing access routes and appropriate advisers.*

Develop new products to attract additional investors

Create new investment vehicles by providing a well defined pool of regulated equity shares. *Objective – to attract additional sources of social investment capital from sources such as charitable foundations, private investors and SRI funds.*

Expand awareness of social purpose businesses

Undertake an awareness campaign of social purpose business investment opportunities. *Objective – to ensure charitable foundations, high net worth individuals and ethical investors realise there is a way to invest directly in businesses to bring about positive social change.*

Establish investment priorities of charitable foundations

Determine the investment expectations and requirements of charitable foundations. *Objective – to maximise the opportunity for charitable foundations to directly support social businesses aligned with their social objectives.*

Build standard measures of social value

Devise a consistent, standard measure of the social return of a business. *Objective – provide investors with a comparable indicator of the social 'value' of investing in such a business.*

Develop fiscal incentives

Investigate and promote fiscal incentives such as enterprise investment schemes (EIS), venture capital trust (VCT) structures and inheritance tax relief, or new incentives along the lines of the community investment tax relief (CITR)
Objective – to encourage investors to channel funds into social purpose businesses by limiting risk and potential lower returns.

It is clear that for a social capital market to become a reality it will need commitment from a number of individuals and institutions. An active working group would establish a forum to review and build consensus on the above recommendations. The result being a dynamic and effective source of equity finance to promote positive social change.

Introduction

Social purpose businesses seek to both maximise social outcomes and generate a profit. There are a growing number of businesses that operate with these dual objectives, successfully creating both social and financial return for investors. The sectors they may operate in include: environmental businesses, child-care provision, housing, health, education, organic food and fair trade.

Like mainstream businesses, social purpose businesses may seek to grow. To achieve this they may have to raise additional finance beyond bank borrowing or early stage investment. Issuing shares in the company through an equity listing is a route to raise significant capital. This builds the number of stakeholders, offers an exit for early stage investors and provides a basis for future investment. Social purpose businesses have approached both listed and unlisted public equity markets to finance their expansion.

Larger social purpose businesses may be able to access regulated public equity markets such as the Alternative Investment Market (AIM) or PLUS Markets. In fact a number of businesses already listed on these exchanges have a core commitment to social or environmental objectives. The benefits of listing here include: access to a ready source of capital, formalised corporate governance and reporting requirements, ability to attract new investors, liquidity for secondary trading of shares and enhanced marketing opportunities. Importantly, institutional funds, which manage the bulk of saving and investment assets in the UK, use these FSA regulated exchanges. Listing on a regulated exchange therefore opens up access to a significant source of capital. This is attractive for social purpose businesses with clearly defined business models and an established path to profitability. However, it may not suit all.

Many social purpose businesses choose unlisted equity offerings instead. This allows a social purpose business to expand ownership but avoid some of the negative factors of the mainstream market such as: price speculation, threat of external control and focus on profit maximisation which may compromise the social mission.

There are barriers, challenges and opportunities for social purpose businesses in the process of raising capital through public equity markets. This report seeks to answer the following:

- why do some social purpose businesses choose not to list on regulated exchanges?
- what determines access to public equity markets and what are the barriers faced?
- how can social purpose businesses be encouraged to access public equity capital markets?

What are the options for a social equity capital market?

It is accepted that social purpose businesses need to expand and diversify. A market mechanism to exchange and list equity would benefit owners, managers and investors alike.

Any social equity capital market needs to be able to:

- attract new sources of private capital
- raise awareness of social investments
- offer the possibility of an expanded range of regulated social investment vehicles
- improve transparency, liquidity and corporate governance standards

A market mechanism for social purpose businesses may not need to be a separate exchange but could be an index, a designated sub-group, or registered mark as part of listing on an established, regulated market. Alternatively, it could be represented by an Internet-based exchange or matched market process.

An appropriately-designed process to raise equity would enable a greater number of social purpose businesses to make public offerings without the risk of compromising their social mission in favour of profit. A process for intermediating between supply and demand for equity capital could enable charitable foundations, SRI funds and socially-minded investors to enhance their investment portfolio. If these offerings were through a well-structured vehicle the shares might qualify for tax incentives via VCTs, ISAs or pensions, which would open a greater supply of capital to the sector.

What is the demand for social equity investments?

Equity investment offers an attractive opportunity for social investors to take part in a developing, vibrant sector that meets a variety of social and environmental needs. Previous share offers have been popular with ethical consumers and other like-minded private investors. If more widely available, they could also provide long-term savings and pensions for investors in the main markets, particularly those who share environmental or social concerns.

Institutional investors, particularly SRI funds, are interested in 'ethical' share offers but the bulk of their investment is often limited by strict investment criteria. Institutional funds are typically unable to hold unlisted shares that are not regularly valued on an FSA regulated exchange. Charitable foundations could unlock the potential of their endowments in a way that suits their own mission to bring about social and environmental change. This could prove a significant opportunity for the market.

What has already been undertaken?

The concept of a social equity capital market has been discussed by a range of industry representatives. A variety of contributors have considered this topic:

- **nef** paper "Homeopathic finance – Equitable capital for social enterprises" (2000)
- Bank of England report "The financing of social enterprises" (2003)
- Co-operation Action's publication *Co-operative Capital* (2004)
- Bridges Venture Capital study "Equity-like capital for social ventures" (2004)
- Jamie Hartzell of the Ethical Property Company paper on "Creating a market for co-operative capital" (2004)
- Skoll Conference on the social capital market (2006)

An active debate has been initiated as to the most appropriate mechanism to channel equity finance to social purpose businesses. Different perspectives have informed the debate, from venture philanthropy seeking new methods to direct charitable funds, to social investors looking for new ways to finance profit-making social purpose businesses. This report focuses on the latter concept of investment, which is distinct from charitable grant giving because a financial return is delivered to investors.

In light of increasing attention on the subject, this report seeks to capture the range of industry views, generate a constructive debate, and build consensus on the way forward. It identifies the key issues to be addressed in order to develop an effective market process to raise equity capital. A critical contribution is the direct consideration of views from social purpose business entrepreneurs, social investors, advisers and institutional fund managers. This will enable identification of practical recommendations to drive the concept of a social equity capital market forward.

Research method

To gather viewpoints from the social investment sector, **nef** carried out a series of in-depth interviews with key individuals representing entrepreneurs of social purpose businesses, social investors, advisors, and institutional fund managers. To compare different views of the equity listing process, social purpose businesses were interviewed that had listed on AIM or PLUS , as well as those that chose not to list on a regulated exchange. The interviews focused on access to equity finance for social purpose businesses, market response to the social purpose business model, and the experience of carrying out an equity listing.

Interviewees were asked for their perspective on how to establish an active social equity capital market to direct finance to social purpose businesses and generate new sources of social investment. Each interview was fully transcribed, and a summary from each individual is available in the appendix of this report.

The 23 resulting interviews reflect a wide range of viewpoints, and provide a diverse response to the questions raised. As expected, given the emerging status of the social investment sector, there was not a general consensus on how to promote access to the equity capital market for social purpose businesses. In general, individuals were positive about the concept of a market mechanism for equity capital, focusing on the practical factors to resolve and issues to consider before such an entity will become a reality.

To capture the diversity of opinion, we presented the findings according to the role of each individual in the social investment sector. Additionally, we have identified recurring themes in the interviews: the tension between social and financial objectives; access to equity finance; the experience of an equity offering; and developing an active social equity capital market.

Interview findings



Piers Linney, Managing Director - Key Homes

"We are listing on PLUS Markets to raise working capital, increase the company's credibility and to put in place a proper structure and corporate governance. Then we can say to local authorities who want to contract with us: we're an established PLC and we have capital, a corporate structure, transparency, access to further capital, a strong board, proper corporate governance and even a share price."

"This is a business and it has to make money. However, it also generates social value. Access to affordable housing is now a key social and economic issue."

"Social businesses that can create both financial and social value could pave the way for a material increase in positive Socially Responsible Investment (SRI) strategies by institutions instead of the current negative investment strategies."

Social purpose business entrepreneurs

Managers of social purpose businesses, like the entities they direct, are a varied group. They seek to balance a range of social, environmental, and financial requirements, which differ in emphasis depending on the business model and its objectives. All of the individuals we interviewed were senior executives of social purpose businesses, being chief executive officers (CEOs), finance directors, or chairmen of the board. The businesses have approached equity finance in different ways, ranging from private, unlisted businesses; to alternative equity issuers; or AIM and PLUS Markets listed companies. The views of these managers capture distinct experiences and expectations of the equity listing process.

Business model – Balancing the social and financial

Regardless of the sector they operate in, the majority of the social purpose businesses we interviewed emphasised the need to balance social and financial objectives, without prioritising one at the expense of the other. With the exception of one CEO, the entrepreneurs agreed on the equal importance of these two elements. Social objectives were felt to be at the heart of each of the businesses, whether they offered organic home delivery, ethical property management, renewable energy or fair trade tea and coffee. Entrepreneurs identified the importance of long-term growth, rather than managing to achieve short term growth at the expense of sustainability or the loss of their core mission. As such, the businesses were not seeking pure profit maximisation or financial return. The one exception to this model was an AIM listed business that placed more emphasis on its profit motive, describing itself as "a commercially viable and profitable organisation alongside and supportive of an independent charity – the objectives are similar but not the same."

Social or environmental objectives are a defining cause for many of the businesses, and play a significant role in its strategy, operation, and governance. Ensuring the continued balance between social and financial objectives represents an important consideration for many businesses in their decision to enter the equity market. The nature of the business model forms the backdrop to considerations of the appropriate company structure, share ownership, trading, and pricing in the market.



Phil King, (Formerly) Finance Director – Cafédirect

“There are two imperatives: one which you would call the social imperative and the other is the financial imperative. It is always a balancing act to get those two right, but we do not focus on one at the expense of the other. They are both equally important.”

“We felt that if we were going to be successful, why didn’t we just go straight to the market and raise funds from the public? ... Long term, the founders’ vision was that Cafédirect should be owned, not only by themselves, but also by people who drank coffee and tea, people who grew the coffee and tea, people who processed the coffee and tea, people who worked in the company.... That was quite a critical part of the thinking to go for a share issue.”

Access to finance

As with traditional businesses, social purpose businesses have adopted a range of financial options in accessing capital. Most of the social purpose businesses have experience of loan finance, and have had equity investment from high net worth individuals (HNWIs), social investors or supportive institutions. Like other mainstream ventures, some have found it difficult to raise seed capital; although one CEO noted that once the model has been proven, “there are lots of people with ethical funds to invest that are struggling to figure out where to put them.”

A majority of social purpose businesses have received equity finance from angel investors or venture capital funds. Venture capital firms were largely viewed as having a short-term interest to maximise the financial return of the investment. One founder and CEO said of venture capital firms, “They are either looking to sell out to somebody or ... produce spectacular short-term yields ... There is too much of the investment market that is looking for large paybacks on relatively short time horizons.” Many of those interviewed echoed the sentiment that the mainstream market had little interest in long-term investment.

The cost of capital from venture capital firms is viewed as high, and comes with a concern about losing control of the business. A concern to limit the undue influence of external investors was echoed by almost all of those interviewed. Funding decisions for social purpose businesses are driven by a strong desire to maintain control and independence. This is perhaps more pronounced in social purpose businesses given the social objectives they champion along with a concern to protect their continuity. As one CEO reflected, “although shareholding is important ... within that the company’s core belief must be protected. That is what differentiates between the main markets, where the shareholder is king, and where the stakeholder becomes as important as the shareholder.”

Most social businesses are relatively small in size, and as with mainstream businesses, this is the most difficult size at which to raise funds. When offering equity to mainstream capital markets, the size of the business contributed to the type of institutional investment funds approached, the perceived risk of the investment, as well as the take up of the offering.



*Jed Emerson,
Senior Fellow, Generation
Foundation – Generation
Investment Management
“What will happen over time
is two things: an increasing
number of companies will
come to market with much
more explicitly enunciated
social and environmental
value components to their
business model, and I think
we will see more traditional,
mainstream companies try to
reinvent some of what they
are doing in order to respond
to the emerging reality of
what it means to create full
value.”*

Several entrepreneurs raised the point that social purpose businesses could themselves be more proactive in raising funds, observing, “sometimes they act more like government offices rather than entrepreneurs.” This was considered to be more predominantly the case with organisations that began as social enterprises, as they have likely had grant funding in the past. Following this point, many managers expressed their desire to be taken seriously by the mainstream market as viable businesses, rather than being relegated to a separate social niche.

Issuing equity

Managers had mixed views about approaching the mainstream market for equity investment. This resulted in the use of different methods to raise equity – whether through a mainstream or alternative equity listing. The motivation to raise equity was driven by a need for capital to grow and pursue new strategies; offer an exit strategy for previous investors; and, in one instance, to simplify a complex capital structure. Similarly many social purpose businesses viewed the equity offering as a positive means of extending ownership to a wider group of stakeholders. As such, many have a large individual shareholder base consisting of customers, suppliers and like-minded investors.

When deciding to list on an established exchange, some managers were concerned that the market imperative would take over, and the business would become too focused on financial returns at the expense of their social mission. This concern was illustrated by the comments of one accomplished entrepreneur and social investor, who reflected that: “At first we did not have to change anything because we were only floating 15 to 20 per cent of the company. And so it was very much on our terms. We subsequently floated more of the company as the years went on ... We moved deeper into the system. It was probably a mistake.”

Some entrepreneurs also noted that they had to come to grips with the fact that in order to grow the company, they needed to give up a degree of control to shareholders. The process of relaxing hold of ownership was easier for those businesses that raised equity from a broad individual investor base, as the threat of one entity buying a significant stake was much reduced.

The listing process itself was perceived as a very cost intensive and bureaucratic process, requiring the devotion of significant time and resources, as well as the need to bring in external expertise. This factor was cited as a strong deterrent not to go to the equity market by the entrepreneur of a privately held business.

Many of the entrepreneurs noted that only a few intermediaries can effectively introduce social purpose businesses to the market, as few understand the business model. Additionally, one entrepreneur noted that as small businesses, they should consider the high fees and overly bureaucratic processes that are often part of the deal with mainstream advisory firms. Those social purpose businesses happy with the advice received noted that advisors were chosen because of their longstanding relationship with the company and understanding of both the social and financial dimension. One entrepreneur reflected, “the banks are quite difficult. If you did not have an ethical bank, really they would not get it at all.” This demonstrates a clear need for a greater number of financial intermediaries and advisors with specific social or environmental sector expertise.

In all cases, the valuation of the company was carried out using conventional financial methods. Entrepreneurs all agreed that the social value created by the company was largely ignored by institutional investors. It was felt that, particularly with institutional investors, the financial model formed the basis of investment interest. While it may have been a factor in the investment decisions of individual investors, entrepreneurs agreed that the social value was not reflected in the share price. Additionally some entrepreneurs felt that investors did not fully appreciate the trade off between financial and social return. One individual observed, “If you are trying to create social as well as financial capital, investors need to be aware that financial returns are not going to be quite so good.” This comment points to the issue of whether social investment necessarily involves sacrificing some financial return. This is likely to vary from one product to another, as well as being a function of different business models. It is evident that greater investor awareness and understanding of the trade off between social and financial return expectations, as well as clarity from the businesses themselves, would help the social investment sector.

Social purpose businesses reflected the view that institutional investors often did not understand their business model. One entrepreneur reflected, “Not a lot of people understand our business, whether financially or our core social ambition.” This was true though most of the businesses presented the investment solely to socially responsible investment (SRI) funds. Some investors perceived the ethical businesses as a charity looking for a donation rather than investment, and felt that the businesses were not committed to making a financial return for investors. Entrepreneurs had to make a concerted effort to explain the

business model and financial return expectations to institutional investors. Several entrepreneurs felt that there was a continuing need to educate the market with respect to their business model, and cited the fact that they are covered by few, if any, equity research analysts.

During the marketing process, most social businesses felt that the social or environmental aspect of their mission was well represented. In one case, however, an entrepreneur felt that the advisors downplayed the social aspect of the business during the marketing phase. Those that issued equity outside of the mainstream market were confident that their social objectives were well represented to potential individual investors. Institutional funds were seen as limited in the extent to which they could invest in social purpose businesses, particularly those not listed on mainstream exchanges. In the case of unlisted equity offerings, this was largely due to investment regulations, and the need for price discovery, liquidity, and the requirement to be able to value an investment regularly. In many cases, the social purpose businesses felt that, despite a concerted effort to market to a range of institutional SRI funds, very few of them bought shares. However, the social purpose businesses all agreed that the process of issuing equity had been a positive experience. Many claimed that they would undergo the process again. Entrepreneurs agreed that the equity offerings had been successful to raise the necessary funds, build a broad base of investors, and increase awareness of the company and the social investment sector as a whole.

Social equity capital market

Social purpose business entrepreneurs were supportive of the concept of creating a market mechanism to facilitate equity listing. They felt that such a market might raise awareness of social purpose businesses and work to attract capital to the sector. Entrepreneurs felt such a social equity capital market could prove particularly interesting to social investors and charitable foundations whose investments might currently be limited to SRI funds. Managers felt that there are significant funds to be tapped into from socially motivated investors, both through private individuals and institutional funds. The market would serve to bring together a set of businesses with shared principles that are presently difficult for investors to identify.

An identifiable group of social purpose businesses could also encourage development of new ethical small cap investment funds. These are currently absent from the market, despite a number of small cap funds specialising in AIM listed companies.



*John Parry - Chairman
– Parry People Movers
“There is too much of the investment market that is looking for large paybacks on relatively short time horizons.”*

“The greatest strength of listing the company has been the ability to attract shareholders, because they have been much more than just providers of finance. They have been providers of ideas and connections, encouragement. An entirely positive experience.”

Whilst there are dozens of mainstream funds with significant investment commitment to the AIM market, few SRI funds operate in this market segment. Those SRI funds with exposure to AIM acknowledge that it accounts for less than 10 per cent of the value of a typical ethical investment portfolio. Small cap ethical funds represent an untapped opportunity to channel finance to social purpose businesses.

Social purpose businesses expressed interest in joining such a market, provided it was structured appropriately. Most entrepreneurs felt that it is an excellent idea, provided the feasibility of accreditation, appropriate indicators, and the basis to allow people into the market could be worked out. Some sort of classification or mark to identify social purpose businesses was recommended as an attractive feature. The concept of a social equity capital market was also seen as a useful tool to strengthen the broader market’s understanding and knowledge of the role of social purpose businesses. One entrepreneur also felt that by integrating such a market within an existing mainstream exchange would help to bring social purpose businesses to mainstream investors. It was felt that a social capital market could bring enhanced credibility, including better transparency and governance, allowing social purpose businesses to attract additional investors.

From a practical point of view, many entrepreneurs indicated that the nature and motivations of businesses would have to be clear prior to allowing them to become part of such an exchange. A key concern for some entrepreneurs was the mechanism for setting the share price and controlling any speculation in the shares. The means of trading was considered significant from the point of view of preventing an external investor from purchasing a controlling stake, as well as to ensure that the value of the shares was not manipulated by speculative investors seeking a short term, purely financial return. To allow the market to work effectively and make it attractive to investors, entrepreneurs indicated that it would be important to attract a critical mass of social purpose businesses.

Social purpose business entrepreneurs did express some concerns about a social equity capital market. Some entrepreneurs felt that being on a social capital market is unlikely to affect the standing of the brand with the consumer, as few people are aware of the financial aspects of a company. Additionally, one entrepreneur felt that there are quicker and easier ways to raise funds from ethical investors. Some entrepreneurs expressed reservations with the creation of a separate grouping of social purpose businesses that



*Jamie Hartzell,
Chief Executive -
Ethical Property Company
"Doing a share issue is
effectively a contract with
your investors. You are saying
what you are going to do and
the investors are buying into
that. You set out your stall.
As long as you have done
it correctly, and the model
works, there is no intrinsic
conflict."*

*"The difficulty for institutional
investors is not so much
buying into the social mission
as being able to make an
investment in a company
such as ours under the
terms of their investment
regulations or policies. ...
I don't think they had any
difficulty interpreting the
social and environmental
mission. In fact, I think
they were only too pleased
to have something that
stood to deliver a bit more
environmental benefit than
Vodafone."*

might set the sector apart and make it less able to influence the mainstream. It was felt that the necessary accreditation process would create extra costs and regulatory pressures. Finally, selected individuals noted that it takes time and money to build up a capital market to the point where businesses want to join it and investors make use of it to trade.

Social investors

Social investors represent an emerging group of private investors, investment funds, and charitable foundations seeking both social and financial value in investment returns. High net worth investors are increasingly committed to finance social and ethical alternatives, and represent a significant source of investment for social purpose businesses. A recent study by the UK Social Investment Forum found that 5 funds in the UK manage £20bn in HNWI assets, of which £1.2bn was managed according to SRI mandates. This provides some evidence of the untapped demand for equity-based social investment products. Similarly, a report prepared by the Charities Aid Foundation in 2003 estimated that UK charities have a total of £47bn in investments; of those interviewed 40 per cent had socially responsible investment policies. Other recent studies by the Esmée Fairbairn and Shell foundations have highlighted the issue of how 'mission related investment' by charities could significantly expand the amount of equity capital available to social purpose businesses.

The social investors interviewed include both private and charity fund investors, but share a common objective to maximise social outcomes using financial mechanisms. The extent to which the interviewees, and their clients, engage in social investment varied, as did their financial return expectations. HNWIs and specialised venture capital funds are currently the most active investors in the emerging social investment sector. There is significant potential for charitable foundations to use their endowments to maximise social benefit, although the evidence suggests that this is currently limited among UK foundations. Small-scale individual investors, or ethical consumers, have shown strong demand for social investment; however their perspective was not considered within the scope of this report.

View of social purpose businesses

The individuals we interviewed agreed that social investment is still an emerging phenomenon with a relatively small pool of investors. They noted that it can be difficult to convince investors of the potential for combined social and financial returns. The investment industry as a whole has yet to embrace



*Jonathan Shopley,
Chief Executive - The
CarbonNeutral Company
"Because it is a new market,
our position is quite unique,
and our growth factors
are defined by a number
of factors over which we
can have only indirect
control. There are very few
comparators to what we do
that we can point to similar
companies with valuations
that have been established in
the market. Those are all the
issues that we are currently
facing as we position
ourselves in the marketplace."*

*"I like the recognition of
companies that are in a
sector where there are social
benefits being returned over
and above profit streams...
But I would not want to
necessarily replace or try and
create a different investment
model."*

the concept that reasonable financial returns can be achieved whilst prioritising social outcomes. In addition, investment in social purpose businesses is viewed as a high risk activity without the accompanying financial return. Investors felt that the market for social investment remained segmented and uncoordinated. Many social purpose businesses are developed by angel investors or social entrepreneurs in a fragmented way, with the social and environmental value poorly defined. The lack of clarity can make it difficult for social purpose businesses to move to more mainstream sources of capital, which expect transparency and consistency as part of investment decision-making. Social investors believe that an increasing number of companies will come to market with more clearly expressed social and environmental values. In general, the development of social purpose businesses of sufficient scale is not thought to be about limited access to capital, but rather not enough entrepreneurs focused on building such entities.

Investment channels and decision-making

Investors believe that social business angels may be the best way for socially driven businesses to find capital, particularly as they believe that many institutional investment funds are sceptical about social businesses. Mainly, the decision to invest in social purpose businesses is based on the outlook and investment priorities of each investor. The financial prospects of an investment, and its ability to make a profit and generate a financial return remain important; though the return might be lower than mainstream investment options. As one investor noted, "Obviously, investors have to eat as well as their investees. So you can do some investments at a lower rate of return, if you think they need help over a hump. It is purely a question of judgement." As such, investment decisions are subject to investors' individual assessment. The expertise and skill of those managing the social purpose business is also a significant factor. As one investor noted, "Good business practice is not at odds with social objectives." In most cases, investment opportunities are offered to investors in an ad hoc manner, on the basis of informal networks or an investor's reputation in the market. Many of those interviewed noted that capital for social purpose businesses is a highly fragmented and pre-developed marketplace lacking formal structures. There is limited connection between investors, and lack of smooth transition from one level of capital to the next.

Valuation

It is clear that investors are seeking a combination of social and financial return. However, as a wider group they have not fully thought through the trade off between social and financial return, and the full implication of taking a discount to financial



*George Latham,
Associate Director, SRI Funds
– Henderson Global Investors
“We assess a company purely
on the basis of the financial
fundamentals and value. We
can however determine that
social or environmental value
will create financial value over
time. Very few fund managers
are able to forgo financial
return for a social benefit. No
one has invested money with
us for charitable reasons, and
we have no mandate to forgo
financial value in order to
capture some unquantifiable
social return. Social value may
have added value in financial
terms, and this is the lens
through which we examine
an investment.”*

return. An advisor to private investors noted that they tend to focus on the instinctive opportunity, rather than valuation. A lack of certainty with respect to valuing social investment opportunities may limit the flow of capital to social purpose businesses. Several investors noted that the sector has done a poor job of expressing the social value component of social purpose businesses, and, in general, capital markets do not like lack of clarity. Investors acknowledged that there is no current system to capture this value.

Social equity capital market

Social investors are cautious about the concept of a social capital market. Those interviewed indicated that it may be too early, with the broader market not yet ready for such a development. Social investors felt that there was still a lot of education required of the general market with respect to social investment. Investors are still unaware of investment opportunities in social purpose businesses, and don't know enough about the basics. In addition, social investors felt that there was not a critical mass of businesses that could make use of such an exchange. Most social purpose businesses are early stage investments that are not yet ready to list on a capital market. Several investors felt that once social purpose businesses are publicly listed, they inevitably lose the social angle. One investor noted, “I am not a believer in the public markets because they are almost invariably driven by one motive – and that is the profit motive.”

From a practical point of view, social investors felt that a social capital market should mirror existing markets by emphasising transparency, common terminology, and third party validation. They indicated that a certification or seal of approval would be required to establish companies as ethical. Investors also felt that there could be better use of fiscal incentives to drive a social investment market. The creation of a framework to measure social value would significantly advance the development of a social capital market.

Advisors

There are very few advisors that specialise in the social investment sector. We interviewed three advisors from an ethical bank, the charity and social economy team of a legal firm, and a corporate finance institution specialising in small to medium sized businesses. These advisors have extensive experience as intermediaries for social purpose businesses, though only two individuals were specifically dedicated to the sector. The advisors interviewed were actively involved to prepare social purpose businesses for equity offering, whether through mainstream or unlisted capital markets.

View of social purpose businesses

Advisors found that social purpose businesses are often small, early stage, higher risk entities with limited liquidity prospects. The social aspect of the business is seen as a positive feature, though its function is viewed differently by the advisors. The advisors with social purpose business experience understood that social objectives are fundamental to the mission. With a different understanding, the mainstream corporate finance advisor noted, "As long as the social objectives are boxed off, ... and operating within the commercial, operational and financial parameters, it is not an issue.... but if the social objectives are at the expense of profitability and general business dynamics ...then shareholders are not going to be that happy."

Investment channels and decision-making

All of the advisors agreed that a business carries out an equity offering because it has a commercial business model that can generate a financial return. Financial drivers are emphasised during the offering process, whether it is on a mainstream or unlisted market. Advisors agreed that the institutional funds' decision to invest is also based on the financial prospects of the company. Advisors found that the flow of social purpose businesses seeking equity investment was intermittent. They indicated that it can be quite difficult to find suitable institutional investors to invest in the equity offering of a social purpose business. One advisor noted that, "one has to do quite a lot of hard work to find socially responsible investment (SRI) funds as they do not come to you". Advisors repeated the point that SRI funds are often limited in the extent to which they can invest in social purpose businesses. One individual pointed out that advisors are forced to take social purpose businesses to mainstream funds when seeking in excess of £10m, because it is unlikely there are enough SRI funds to generate this level of capital.

The typical investor base of many social purpose businesses is made up of individual investors, particularly for businesses listed on a mainstream exchange. An issue identified with unlisted equity offerings was limited liquidity and lack of price discovery. Also, the cost of a listed or unlisted equity offering can be prohibitive for many social purpose businesses. The time and cost of a mainstream market listing can run to 10 per cent of the amount raised. Unlisted equity offerings also require significant marketing and administration, which can absorb roughly 8 per cent. Advisors noted that while many social purpose businesses are concerned about the loss of ownership that an equity offering may bring, the mainstream market is technically not in favour of restrictions on share ownership and control. The desire to retain control was a

factor in some social purpose businesses' decision to remain on an unlisted market.

Valuation

Advisors were consistent in their view that the value of the business will ultimately be based on cash generation and profitability. As such, value is based on the future growth prospects of the company. None of the advisors included social value as part of the valuation in preparation for the equity offering. They agreed that social value is very difficult to assign a quantitative value to, and remains a challenge, particularly because markets are focused on financial valuation. Advisors believed that the importance of social value to social investors varied. There is a range of investors whose interest varies from maximising financial return through tax vehicles to those who view the social return as primary. One advisor noted, "It is a massive range. You could pull out a mean and a median, but they would not represent the breadth. For some people the social value is irrelevant and for other people it is everything." However, investors are still seeking to achieve a guaranteed and regular financial return, even if it is at a reduced rate.

Social equity capital market

Advisors to social purpose businesses were cautious regarding the creation of a social capital market. Advisors noted that it would be difficult to create a market without a critical mass of social purpose businesses ready for an equity offering. Some advisors felt that current market mechanisms are sufficient to meet the equity capital needs of social purpose businesses. In addition, it would be a challenge to develop a business model for a social equity capital market to operate profitably given a limited trading volume and the lack of liquidity. Infrequent trading would generate insufficient revenues to cover the cost of running the exchange. Additionally advisors felt that it would be difficult to define what constitutes a social purpose business, and therefore which businesses would have access to the exchange.

Advisors felt that many social purpose businesses would identify themselves as a mainstream profit-maximising business, with the added objective to do business in a more responsible way. Given this view, they might not be willing to classify themselves as social businesses that are distinct from the mainstream market. In order to provide protection from external control – an important feature for many social purpose businesses – they would have to trade at a discount to the mainstream market. This feature may put off many mainstream company directors, as they may hold options linked to the share price. However, several advisors agreed that

a social equity capital market would widen the appeal of social investing to the general public by providing enhanced comfort and accessibility. One advisor noted that a social equity capital market would attract greater institutional investor interest because of the existence of market makers and the ability to value shares readily.

SRI fund managers

The market for socially responsible investing (SRI) has grown significantly over the past 10 years, and there are now approximately 75 retail ethical investment funds in the UK which apply environmental, social or other ethical criteria to the screening and selection of investments. The UK retail market was estimated by EIRIS in December 2005 to represent £6.1bn in funds under management and almost 500,000 individual accounts. Additionally an increasing number of institutional funds are screened according to ethical criteria or have adopted an ethical engagement policy. These actively managed investment funds represent the collective assets of pension funds, insurance companies, charities or churches.

The (SRI) fund managers interviewed represent a diverse body of institutional investors that have adopted an ethical screening policy, to frame their investment decisions. The ethical frameworks applied by SRI funds vary and reflect a range of objectives, whether to exclude undesirable activities or positively to select businesses with good records of corporate social responsibility.

A very limited number of SRI funds have adopted a proactive investment strategy to direct funds to social purpose businesses. Awareness of social purpose businesses, particularly those with unlisted shares, was patchy amongst the SRI fund managers interviewed. The vast majority of SRI fund investments are concentrated in the top 350 FTSE companies, with Vodafone, Pfizer, Johnson & Johnson, Citigroup and Microsoft as the most frequent stocks in SRI portfolios, according to a 2003 SiRi Group report.

View of social purpose businesses

SRI fund managers consistently find it difficult to invest in social purpose businesses. Fund managers cited the small, early stage nature of most social purpose businesses as a key limitation, given the funds' risk profile and need to maintain sufficiently liquid investments. As social purpose businesses are frequently seeking to raise funds in the equity market for the first time, they are regularly perceived as being propositions rather than actual businesses. They are described as often lacking in assets or proven management expertise, coupled with a hesitancy to focus on



Mark Evans,

*Head of Family Business
– Coutts & Co.*

“I think there is general interest from the charity clients that we manage in social funds, and there is growing interest from private clients in understanding what social funds are all about.”

growth. As small cap companies, social purpose businesses are described as “too young, too small, the business is less stable, and it is difficult to meet management.” Almost all funds have a limit, whether formal or informal, to the amount of funds they can allocate to small cap investments. Given the higher risk factors associated with small cap investments, fund managers expect an accompanying higher rate of financial return.

Despite the fact that social purpose businesses do generate financial return for investors, the seeming lower return profile of such entities is seen as a constraint. Several fund managers mentioned the lower return profile of social purpose businesses as a limiting factor. As one fund manager commented, “If you invest in ethical businesses, you know you are going to get less of a return.” Following this point, another individual commented, “Decent companies that do not get very far in terms of growth are not of great interest to the investment community.” As such, proactive investment in social purpose businesses from the SRI funds has been extremely limited to date. Institutional investors find it particularly difficult to invest in social purpose businesses that are not listed on mainstream equity capital markets. Importantly, regulated savings and pension products benefit from both the institutional capacity and support regulators provide, as well as the additional capital that tax benefits attract.

Investment channels and decision-making

SRI fund managers observe that it can be difficult to source potential investments in social purpose businesses. A small number of social purpose businesses approach SRI funds for investment. A select number of fund managers indicated that they were approached to invest in equity offerings, but emphasised that this primarily consisted of businesses offering environmental technologies or renewable energy. One fund manager noted that it is difficult for investors to get involved with a business on an ethical basis alone, as this motive may cause one to lose sight of the investment fundamentals.

All of the fund managers agreed that investment decisions are made on the basis of financial criteria. To underline this point, several individuals stressed that they have no mandate to forgo financial return in their investment decisions. Fund managers expressed that they are challenged to maximise financial return while avoiding certain sectors, such as oil and gas, which have been screened out of their ethical portfolios. Given this constraint, some managers find it difficult to outperform their benchmark indices, and are therefore reluctant to take on greater risk in small cap, illiquid stocks without the prospect of significant financial return.



Rodney Schwartz -
Founder and Chief Executive
- Catalyst Fund Management
and Research Ltd

“Once you’re publicly listed, you’ve lost the social angle. The market is designed to allocate capital not deal with social criteria. That is a bargain you make when you list.”

“The only hope for social businesses, wishing to stick to their social agenda, is to raise capital from investors who are investing for more than purely financial reasons.”

Putting a valuation on social purpose businesses

Fund managers felt that social purpose businesses can sometimes be difficult to value or to have a firm understanding of the financial drivers and objectives. Many of the fund managers indicated that the financial criteria are more important than social objectives in assessing a social purpose business. A significant number of those interviewed expressed that social value is difficult to measure, has not been done successfully to date, and might be best captured in financial terms. This statement reflects a perception that any benefit a company creates for its clients should be captured by financial figures, such as more positive sales results. When valuation is carried out for a social purpose business, fund managers indicated that the process would be the same as that for traditional businesses – based on financial value creation. The market does not attribute a premium to social purpose businesses because of the social value they create. If anything, there remains quite a lot of scepticism amongst SRI fund managers with respect to the role of social value in the marketplace.

Social equity capital market

SRI fund managers had mixed views in response to the concept of a social equity capital market. While they tended to think that it was a good idea, they raised a number of practical concerns. In general, they saw it as a good thing if it could bring about improvement in disclosure, corporate governance, reporting and access to information for social purpose businesses. Investors would be interested in the enhanced transparency such a market could bring.

In addition, fund managers felt that a social equity capital market could function positively to change perception of the socially responsible investment industry. It could act as a vehicle for collective marketing, which would raise awareness of the option of social investment amongst both institutional and retail investors. Fund managers agreed that the market ultimately could be successful to provide an additional channel for capital to social purpose businesses. Managers also felt that it would make sense if it allowed social purpose businesses to avoid having their performance benchmarked solely against mainstream profit-maximising businesses.

On the practical side, several managers emphasised that there would have to be stringent rules to determine that listed businesses were in fact social or ethical in nature. Specific qualification criteria would be needed. This accreditation process would likely require oversight from an independent body or qualified intermediaries. Fund managers also felt that a social

equity capital market could be driven by legislation or tax incentives, to support investors seeking to achieve comparable market returns. Such incentives could help to drive liquidity to the market.

Fund managers also indicated that there might be problems identifying a critical mass of businesses to list on a social equity capital market. They expressed concerns that there also could be problems with liquidity and insufficient trading volume. Those interviewed also expressed the concern that it will be a high-risk market, by definition, which is likely to have quite strong sector biases. The social capital market would likely have a number of service businesses, and a limited number of manufacturing businesses. Given these trends, fund managers felt that it might be better for investors to buy exposure to the range of companies listed on the exchange as a whole, rather than investing individually in the companies.

Several individuals pointed out that branding an exchange or investment vehicle as purely social tends to create a niche cut off from the rest of the market. They emphasised that a social capital market must have a differentiating factor for investment managers to want to buy into it. Finally, they reiterated that once social purpose businesses go public, they must be able to deliver on their financial targets, measured by revenue and profits. They will lose investor attention if they do not deliver on their financial objectives.

Key issues

These views capture different perspectives of social investment actors regarding the development of new mechanisms to enable the social equity capital market. The findings show that there are a series of practicalities to be considered. At the most fundamental level, industry actors have identified a tension between the core social mission of many businesses and the reality of a market seeking to maximise financial return. Many social purpose business entrepreneurs have reservations about joining an equity market that does not share its core values, and therefore choose an alternative means of raising equity capital.

It is clear that mainstream equity markets can pose a challenge to social purpose businesses, particularly those seeking to deliver social value in conjunction with financial return. As the interviews indicate, factors that discourage many social purpose businesses from listing on regulated public exchanges include:

- speculation
- short-term investment horizon
- resource and cost implications
- ownership and control requirements
- financial return expectations that are often perceived to be inconsistent with businesses' social mission
- limited management experience of equity listing
- the feasibility of obtaining finance from alternative sources

Accessing the mainstream market poses less of a challenge to businesses that produce socially beneficial products or services via a traditional profit-maximising business model. Most social purpose businesses, however, are not willing to sacrifice their social objectives to generate more robust profits for shareholders. They require investors that understand their hybrid business model, and share a belief in the businesses' core objective to create social value, while generating a reasonable financial return for shareholders.

A common point across the interviews was a general concern regarding how a selected set of social purpose businesses would be identified. Too narrow a definition would restrict the pool of potential candidates, while too broad an understanding would dilute its relevance. Some form of accreditation or classification of the businesses may be required. Who would administer this process? There is a danger that trying prescriptively to define the social, environmental or ethical credentials of businesses could be counterproductive.



*Gordon Roddick,
Co-founder & Social Investor
- The Body Shop
"I am not a believer in the public markets because they are almost invariably driven by one motive -- and that is the profit motive. ... I would advise all businesses that are interested in being a social business to keep away from the current market."*

"We subsequently floated more of the company as the years went on. The business is now 30 years old. ... We moved deeper into the system. It was probably a mistake. We were probably much more political than just social. Probably as quite highly politicised entrepreneurs we were not suitable to be a public company.... Frankly I would not do it again, no."

A related point is whether a critical mass of investment-ready social purpose businesses exists. This is difficult to determine given the range of businesses engaged in providing social or environmental goods and services. However, as a rough indication, the DTI's 2005 Survey of social enterprises across the UK estimates that there are approximately 3,000 social enterprises with turnover above £1m. These enterprises, in combination with other listed and unlisted businesses engaged in social or environmental activities, would represent a significant pool for equity investment as they grow.

The next section looks at the issues specific to the mainstream and unlisted options for raising equity, taking into account the collective views of those interviewed. This review leads us to a consensus on the challenges and requirements of establishing an appropriate mechanism for social purpose businesses looking to make an equity offering.

[Key issues regarding mainstream equity offering](#)

[Loss of social mission](#)

The principal concern of many social purpose businesses is that the profit motive of the mainstream equity market will inevitably erode the core social mission. In the words of one social investor, "Once you've publicly listed, you've lost the social angle. The capitalist system is corrupt." Investors in the mainstream market are primarily interested in financial return. As the interviews with fund managers and advisors indicate, a business is valued according to its financial drivers and the business model is evaluated according to its potential for growth. Should the social purpose business successfully attract institutional investors, investment managers clearly indicate that they seek growth in the share price, reflecting a positive financial performance.

[Financial return expectation](#)

Once a social purpose business enters the mainstream market, attention centres on financial results, which are closely monitored. Quarterly profit reports directly relate to share price. In most cases, if a business fails to produce financial results in accordance with its projections, investors will lose interest and sell the stock. Social purpose businesses are seeking patient investors that understand the long-term value created by their business model. Short term buying and selling of stocks, as is often the case with the mainstream equity market, is not consistent with sustainability.



Ella Heeks,

Chief Executive - Abel & Cole

"We have a very strong wish to maintain the independence of the business in order to allow ourselves room to spend on the social and environmental initiatives, and to have control, in particular, not to have to compromise on those areas."

Lack of shared values

In this context, it may be difficult to find investors from the mainstream market whose interests are aligned with those of the social purpose businesses. Social purpose business managers find that the market does not understand its objectives, and is driven by short-term thinking. Investors in the social equity capital market must be clear that a social purpose business does not intend simply to maximise financial returns for shareholders. A social capital market would need to attract funds from social investors and charitable foundations that share the values of the social purpose business.

Speculation

The market's perception of future financial return can result in speculation, driving up share prices on the basis of heightened demand. As shown by the rise and fall of the dot com bubble, the market can at times be driven by an 'irrational exuberance'. Such speculative pressure raises concerns for many social purpose business managers that share price may not reflect the true underlying value of a business. Under such conditions, the market is driven by short-term profit seeking, rather than long term investment in the outcomes, whether social or financial, that a business can produce.

Ownership and control

With no restrictions on ownership, shares in a social purpose business could be freely traded to investors with limited or even conflicting understanding of the business model. Without some form of control, external shareholders might have undue influence over the strategic direction of the company. Over time, a social purpose business could lose control and eventually be taken over by a competitor with alternative objectives. This is more likely to be the case on a mainstream market that avoids restriction of shareholder rights. Issues of ownership and control have a direct influence on the price of a share. Shares with ownership or voting limitations trade at a discount in the market. The concern about loss of control is evident in the structure of the equity offerings of some social purpose businesses seeking to reserve strategic control for a core group of owners. Protection of the social purpose business through restriction on voting rights, level of ownership and exchange of shares may be required.

Lack of intermediaries

In addition, very few advisors exist that can support social purpose businesses to list on the mainstream market. Some leading corporate finance advisors to social purpose businesses are not registered to represent equity offerings to the mainstream market.

Social purpose businesses view the process of listing as arduous and resource intensive. Several social purpose business managers indicated that they are not sufficiently informed about the equity listing process, and would need advisors to help them consider this option. A group of specialist advisors would work to develop investment-ready social purpose businesses and prepare them for the market. A social capital market would require this distinct set of intermediaries with experience of social purpose businesses and links with the social investor base. Ultimately these advisors would act to bring early stage and venture capital investments to the social capital market, providing an exit for investors and contributing to a more mature social investment infrastructure.

Reporting requirements

Social investors would like to see the discipline of the market bring about consistent reporting and greater transparency for social purpose businesses. At present, investors find it difficult to access management and receive regular performance reports. Following the initial offering, investors feel that they receive limited information about social purpose businesses, even though they are listed on mainstream exchanges. The existing AIM and PLUS Markets are viewed as having less rigour in their listing and reporting requirements than the main board of the London Stock Exchange. Listed social purpose businesses are poorly covered by equity research analysts. Both entrepreneurs and investors feel that the social purpose business model is poorly understood as a result. An attention to corporate governance requirements, social auditing and clear process of reporting for social purpose businesses is a distinct role for the social equity capital market.

Consensus on definition

Many of those interviewed reflected that a key challenge for the mainstream market is to determine what constitutes a social purpose business. Attempts to define groupings of 'socially responsible' or 'ethical' businesses in the past have struggled with the wide nature of such concepts. The market requires a clear definition of what constitutes a social purpose business, and which businesses are eligible to list on a social equity capital market. It may be difficult to achieve consensus on the definition of a social purpose business, even more so given the diversity of opinion present in the mainstream market.

Accreditation

To verify social purpose businesses, ensure the legitimacy of a social capital market, and distinguish it from existing socially responsible indices, a system of accreditation may be required. The infrastructure to implement and maintain a system of accreditation



Mark Mansley,

*Strategy & Communications
Manager – Rathbone
Greenbank Investments*

“We find that a lot of our clients want to invest in smaller, more interesting green and ethical companies, but against that we have to factor in the risk and liquidity issues.”

“Liquidity is important. All things being equal we would like these investments to be listed on AIM or a market like that if they can be. There is a matched bargain basis for dealing with unlisted shares, but it’s not as satisfactory, as liquidity is a bit mixed. It is less the ability to trade, and more the fact that the share is regularly being valued that is important to us.”

could create additional costs and resource demands for social purpose businesses. Some form of social audit would be required on an ongoing basis. The role of accreditation may be best carried out by qualified intermediaries with specialist understanding of social purpose businesses, who would carry out accreditation as part of the due diligence process.

Key issues regarding unlisted equity offering

Instead of approaching the mainstream equity market, some social purpose businesses have opted for an unlisted equity offering. Businesses such as Cafédirect, Traidcraft, Baywind Energy Co-operative, the Centre for Alternative Technology (CAT) or the Ethical Property Company have successfully raised equity capital by engaging with a broad range of stakeholders. These social purpose businesses maintain an extensive individual investor base, often appealing to members, customers or employees to purchase a limited equity stake. Most unlisted offerings have a minimum share purchase of several hundred pounds, with an average individual holding of several thousand pounds. For organisations structured as Industrial and Provident Societies (IPS) there are further legal constraints that limit the maximum shareholding to £20,000; this acts as a deterrent to institutional investment funds. Despite added constraints, unlisted equity offerings are often fully subscribed, attracting significant demand amongst like-minded private investors. Through an unlisted equity offering, these social purpose businesses have retained a significant degree of control over their operations, and avoid the associated threat to social mission.

Social purpose businesses that have recently completed unlisted equity offerings have committed to pay dividends to shareholders; though these are often at a lower rate of return given the social value created. This represents a step forward over earlier offerings, such as CAT, which have not provided for the distribution of profits. The Ethical Property Company has returned dividends to shareholders with an average dividend yield of 2.8 per cent for the past 6 years. Likewise, Cafédirect voted in March 2006 a dividend of 2p per share for a yield of 2 per cent. Even Traidcraft, which did not allocate dividends for 18 years, voted its first dividend of 2.5p per share to shareholders in 2004. These social purpose businesses regularly report on the social and financial outcomes achieved. In some cases, the level of reporting to shareholders is consistent with, and in some cases exceeds, that of a mainstream market listing – particularly in areas of social and environmental impact. In short, unlisted equity offerings have worked well for a distinct set of social purpose businesses.



Phil King, (Formerly) Finance Director– Cafédirect

“One thing the founders put in place was a limit on the number of shares that any one person could own ... What that means is that we can’t list the shares on a public exchange, which then means that they are not as liquid as they might be, and this is the concern of a number of institutions. They felt that if it wasn’t listed on a public exchange there might be difficulty in disposing... as and when they wanted to. That was the major concern.”

More broadly, the unlisted equity offering raises several issues for social purpose businesses:

Cost and marketing

The cost of carrying out an unlisted equity offering can be prohibitive. Significant effort is needed to market the offering to a broad range of potential investors. Advisors supporting an unlisted share offering suggest that it can cost between 8 to 9 per cent of the capital raised. The success of previous unlisted equity offerings has been due to the existence of a dedicated group of investors willing to forgo some financial return in order to support a good cause. Also, having an asset portfolio, in one instance, and a well-known brand name, in another, helps to attract investment. Without a broad base of supportive stakeholders, other social purpose businesses might find it difficult to raise the capital required.

Illiquidity

Once individuals invest in an unlisted social purpose business they may find it difficult to trade these shares. The process for buying and selling unlisted equity shares is currently carried out through a matched bargain process whereby all bids are handled through a designated broker. This process may be adequate for the individual investor base with relatively small average shareholdings and a long term commitment to hold shares. The current trading volume of unlisted shares averages approximately 1 to 2 per cent of shares outstanding. However, the lack of liquidity in unlisted shares, and regular independent valuation of shares (e.g. price discovery), may stop larger investors, such as institutional funds, charitable foundations, and high net worth individuals, from participating on a significant scale. A lack of liquidity in these shares would prove problematic for a dynamic secondary market to develop.

Valuation

A market offering clear, consistent and transparent information on available bids and offers would be required to build a trade in equity capital on a wider scale. Consistent and independent means of valuing shares must be worked out. Unlisted equity offerings have worked well at their current scale, but the means of determining share value has not been standardised. In some cases value is worked out by internal assessment of the company and its advisors. This process will not be sufficient for institutional investors representing savings, pensions and charitable funds to participate on a larger scale. To promote access to equity capital more widely requires common terminology, third party validation, and an independent means of determining share value.

Unregulated status

Investment in unlisted shares is not open to many institutional investors and managers of charitable foundation assets because of the lack of price discovery, illiquidity, and absence from an FSA-regulated exchange. A regulated market mechanism could work to offer new investment vehicles that would overcome these key limitations. The creation of a well-managed and regulated equity market mechanism would open the possibility of new structures for social investment.

Critical mass of social purpose businesses

An appropriately designed social equity market mechanism would also work to attract social purpose businesses that have previously opted for the unlisted option. By bringing together multiple sources of investment capital with the shared objective to achieve social outcomes, a critical mass of social purpose businesses will develop. This argument is supported by the experience of the UK's venture capital market, which demonstrates the effectiveness of establishing a pool of available equity capital to encourage new enterprise. The availability of social investment capital can act as a prompt to entrepreneurial activity in social purpose businesses. This will be strengthened by the development of technical support to build management expertise in equity finance instruments.

Next steps

This report has identified a number of issues that will need to be addressed to create a more robust process to channel equity capital to social purpose businesses. The views of a range of participants point to a series of considerations that must be resolved. The objective of carrying out this research was to identify the key tensions relating to the process of equity listing. This debate seeks to build consensus on practical steps forward in order to establish a market place for the trading of social purpose businesses' equity, particularly to allow them to tap into a larger sources of investment. In this section we consider practical recommendations that could be adopted to press ahead with building an active social equity capital market.

Establish a common information point

An important step is to create an online forum to bring together the range of information and initiatives involved in providing equity capital to social purpose businesses. This forum would work to disseminate information, and to promote opportunities to invest in these social purpose businesses. At first, this website might feature social purpose businesses that have unlisted equity, but could expand to include a range of social investment vehicles.

The overall objective would be to raise awareness of social purpose businesses as an investment opportunity and to generate greater understanding of equity listing as an option for the businesses themselves. An existing model of this type of forum is the Development Capital Exchange, which provides information about early stage investment opportunities.

Develop social capital market prototype

A critical step would be to carry out a feasibility study and business plan to determine an appropriate market mechanism to raise and trade equity capital. A business plan would provide a reference point for the ongoing debate on how best to structure this market place. This plan would not need to be definitive, but would serve to focus the debate. In particular, this plan would offer a framework to begin to resolve practical issues identified above, and address factors such as: how should a market mechanism be structured, where would it be located, how much would it cost, and how to accredit social purpose businesses.

Explore partnerships with alternative market mechanisms

A possible option to encourage a social equity capital market would be to partner with an existing, regulated exchange. This has obvious benefits by building upon an existing platform with established infrastructure and investor base. Possible partners range from the mainstream AIM or PLUS Markets, to the Internet-based exchanges. Further exploration of the feasibility and benefits of acting jointly with each partner would be required.

Build links with ethical investors

Individual investors have demonstrated significant interest in 'ethical' or social purpose share offerings. The bulk of investors in unlisted equity offerings regularly come from the consumers, employees, suppliers or community members who actively support the business' social mission. Existing ethical investors would be valuable partners in the creation of a social equity capital market. There is a need to build a formal network and bring additional individual investors to social purpose businesses, and to raise awareness of this investment option.

Support social purpose businesses to raise equity capital

A key factor is the existence of a critical mass of social purpose businesses prepared to enter the equity capital market. It is clear that there is a range of businesses with a need for capital in order to grow. It is less evident that these organisations have the appropriate skills, expertise, and information to carry out an equity offering. The option of raising equity through the market is likely to be viewed as a specialist activity requiring significant support

and external advice. To prepare these businesses for market, a range of technical assistance and investment support may be required.

Develop investment intermediaries

There is a lack of advisors with expertise in dealing with social purpose businesses and their investment needs. These businesses require advisors that understand both their social and financial objectives. These specialists could play a key role in establishing a framework for accreditation of social purpose businesses. Similar to the existing model of nominated advisor (nomad) representation, these advisors would help to build a continual pipeline of equity offerings, support businesses in the listing process, and carry out due diligence functions. More broadly, such advisors could serve to raise awareness of an equity offering as an option for social purpose businesses.

Develop new products to attract additional investors

To attract additional sources of social investment capital, new investment products should be developed. A designated market of social purpose businesses would enable the creation of new investment vehicles by providing a well-defined pool of regulated equity shares which could be distinctly recognizable as a form of social investment. These investment products would attract funds from charitable foundations, private investors, and SRI funds seeking structured social investment opportunities. Such vehicles could work to raise awareness of social purpose businesses in the market as a positive means for investors to achieve both social and financial return.

Expand awareness of social purpose businesses

The growth of SRI funds, which represent £6bn in funds under management, has shown significant appetite for ethical investment alternatives. Yet most charitable foundations, high net worth individuals, and ethical investors remain largely unaware of the option to invest directly in the shares of social purpose businesses. Equity investment in these businesses is often fragmented and ad hoc, and has no collective marketing to achieve widespread distribution. A well-designed market mechanism would play a critical role to raise awareness and develop a proactive way of investing directly in businesses that achieve positive social change.

Establish investment priorities of charitable foundations

An important next step will be to determine the investment expectations and requirements of charitable foundations. Foundations could play a significant role to support social purpose

businesses that are in keeping with their social objectives. By actively investing in direct social investment, foundations would be able to maximise social or environmental outcomes. The positive impact of such proactive, mission related investment could potentially far outweigh the scale of their current grant making strategies. Foundations can act as pioneers to champion and advance the social equity capital market, channeling funding to a host of new social purpose businesses following their wider strategic aims.

Build standard measures of social value

A consistent, standard measure of social return would benefit the market. This would provide investors with a comparable indicator of social outcomes created, and would demonstrate clearly the benefits of investing in social purpose businesses. Such an indicator would promote transparency, comprehensive valuation, and effective decision-making. This tool would also help social purpose businesses to work towards maximising social value creation. While different initiatives exist to measure social value, this level of use remains elusive.

Develop fiscal incentives

To encourage investors to channel capital to social purpose businesses, new equity offerings should make effective use of fiscal incentives. Existing mechanisms such as the enterprise investment scheme (EIS), venture capital trust (VCT) structures, and inheritance tax relief could be used actively to benefit social investors. In addition, following the model of the community investment tax relief (CITR), there could be a case to develop new incentives to direct investment to social purpose businesses.

A number of steps will be required to make equity capital more available to social purpose businesses. This requires engagement and commitment across a number of individuals and institutions. Practical actions should build upon social investment initiatives carried out to date, and will need to draw upon the expertise of an array of industry actors. The above recommendations are likely to require different institutions to work together to achieve a common outcome. A successful approach might be to designate an institution to co-ordinate and oversee a working group from the sector. Formation of an active working group would establish a forum to review progress and push forward with the creation of a social capital market. On this basis, the above recommendations could be turned into action points to bring about the social equity capital market.

Appendix

Appendix

Rory Stear, Chief Executive, Freeplay Energy Plc

John Parry, Chairman, Parry People Movers

Piers Linney, Managing Director, Key Homes

Jamie Hartzell, Chief Executive, Ethical Property Company

Phil King, (Formerly) Financial Director, Cafe Direct

Ella Heeks, Chief Executive, Abel & Cole

Gordon Roddick, Co-Founder and Social Investor, The Body Shop

Jonathan Shopley, Chief Executive, The Carbon Neutral Company

Juliet Davenport, Chief Executive, Monkton Group plc

Mark Mansley, Strategy and Communications, Rathbone Greenbank

George Latham, Associate Director, SRI Funds, Henderson Global Investors

Gary Laing, Broker, AXA Investment Management

Michael Fox, SRI Fund Manager, Co-operative Financial Services

Alex Illingworth, Director, Global Equity Funds, Insight Investment Management Limited

David Richardson, Divisional Director, Investment Management, Rensburg Sheppards Investment Management

Suzie Kemp, Vice President, Credit Suisse Asset Management, Credit Suisse Fellowship Fund, CS Premiership Fund

Joel Morland, Equity and Investment Manager, Triodos Bank

Malcolm Lynch, Partner, Charities and Social Economy Department Wrigleys Solicitors

Mark Evans, Head of Family Business, Coutts & Co

Mark Taylor, Charles Stanley & Co

Jed Emerson, Senior Fellow Generation Foundation, Generation Investment Management

Rodney Schwartz, Founder and Chief Executive, Catalyst Fund Management & Research Ltd.

Rory Stear
Chief Executive
Freeplay Energy Plc

Manufacture of self-powered energy products
Turnover 2004: \$6.3 million (£3.6 million)

AIM (FRE) listed in March 2005

Business Objective

"We are an energy business. Our intellectual property is largely around the harvesting of human energy – its storage and its controlled release to power a wide variety of largely portable consumer electronic products, including radios, flashlights, and cell phone chargers. ... Our core purpose is providing access to energy to everyone, everywhere, all of the time."

Social/Environmental Commitment

"Although our products are socially responsible... we have never tried to peg ourselves into being an environmental company or only a socially responsible company, but it is right at the centre of our brand, because we believe it is good for business and good for the community at large for organisation to be as committed and responsible as possible. The business model is a focussed business alongside, and supportive of, a focussed independent charity."

Balancing Financial & Social Objectives

"We do not find it difficult. We have a shared purpose with the foundation... The foundation's core purpose is similar, but their focus is to provide access to information to everyone, everywhere, all the time. They are more of a media and a content organisation. Our technology closes the circle because it is sustainable.... Our products are environmentally and socially empowering in that they are recyclable and there are no disposable parts to our products, nothing being thrown away. The two agendas run parallel. One is to be a commercially viable and profitable organisation the other is to be a charity but there are many touch points between the two."

"The Foundation is great for our brand. We have just had 16 articles about their work in The Times over the December period. And that can't hurt the Freeplay brand at all. It is very, very positive. We share a brand at the end of the day... It is a mutually beneficial and supportive relationship."

Investment rationale

"They looked at us as a commercially viable investment. It is common cause that renewable energy is an increasingly important

area.... People from the earliest days wanted to be involved in that from an investment point of view, and therefore looked at Freeplay as an investment proposition – the quality of the patents, the quality of the management, and all of the traditional things for investing in a company. There are also people who are invested in Freeplay because of the social dimension... Other people are just involved because they think the company is going to make money, and they want to be a part of that.”

“In my opinion that is what is required: socially responsible companies need to be in the mainstream and have a very effective group of investors and supporters, which include people that are there for purely environmental or humanitarian reasons all the way to people who just want to make money.”

Effect of listing on business

“I think the process of listing simplified the business. It had become pretty complicated from a private equity point of view because it is difficult to have high net worth individuals alongside funds. They have different agendas. It becomes complex to manage and balance those objectives. It is far easier as a public company to do that.... Commercially the business is a lot easier to manage than it was. There was a complicated capital structure and a complicated shareholders agreement as a private company.”

“Someone else might end up running this company, and they might not share my views, or those of the current Board. That is always a possibility, and it was therefore important to entrench the Foundation’s forward position via a 5-year contract. Also from a new investors point of view I wanted them to be able to see that this was important to us and we have a long-term commitment, and that part of investing in Freeplay was them understanding that that commitment to the Foundation was in place. We would probably look at that commitment in another year or two and give it another five years.”

Advisor representation

“I found the process to be very bureaucratic, and for an entrepreneur it was counterintuitive. I found the process of working with some of the advisors, especially some of the accountants, to be close to traumatic.... I think that there is a serious discussion that should be had with smaller companies going to the AIM, and what advisors are appropriate for them given their size... We ended up with the most horrendous fees and a complete overkill approach....”

"If anything our advisors tried to play our social mission down. On the road show I certainly put it front and centre what we stood for. I was asked stupid questions, like "Are you looking to take our money just to give it away to charity?" There were some of those attitudes. But once people understood the separation between the company and the foundation...that worked well with the investment community. To my knowledge no one did not invest as a result."

Valuing the social mission

"They absolutely ignored it. They just looked at a historical basis and projections for the year ahead. If anything our valuation was absolutely written down because we had restructured the business quite significantly. We would have been better off going to the market as a start up in terms of valuation rather than having had a track record. There was no acknowledgement of our brand or of all the intellectual property that we own, or certainly of the fact that we are a benchmark socially responsible business. None of that was factored into the pricing. It was priced up by the nominated advisor, and people followed it because they thought it was cheap or otherwise."

"I think that we just get benchmarked against consumer electronics companies. We are an energy business, and would want to be measured as such. I do not think that the market is terribly sure of how to position us, and that is one of the things that we need to work on. I certainly do not think that people are looking at us as a socially responsible business even though it is well known that we are."

Creating a social capital market

"I think it is a fantastic idea.... I think it needs to be more mainstream than GEXSI. If an organisation like the LSE were to get involved, it would straightaway bring it into the mainstream. I think this is the point: You want to be seen to be having a proper seat at the table, not just some bunny-hugging fad."

"I see social responsibility as being a mainstream best business practice, and in everybody's best interest....I think that a market that attracts socially responsible investing, where people can easily find companies that are socially responsible would be a very, very good thing."

"The companies must be sustainable. We are not talking about charity here, so the kind of companies that I would be looking for to feature would be companies with a serious long term future."

And then I would be interested in how you are going to measure that.”

“There is a whole raft of discussion and debate about socially conscious investing, socially responsible companies, and I am looking forward to how that all plays out, the blended value approach. I try not to get terribly caught up in all of that. Businesses must be run as businesses.”

John Parry

Chairman

Parry People Movers

Builder of environmentally sustainable trams, railcars and ultra light rail systems. Turnover 2004: £5,315

Raised unlisted equity capital 1992

PLUS Markets (PPM) listed in December 1995

Business Objective

“The objectives of Parry People Movers follows a very strong environmental focus by both the board and the shareholders. The company was formed out of the wish by what was originally the parent company, a company called Parry Associates, to consolidate its work in human settlements. ...In the course of developing its work in human settlements, Parry Associates identified that transport was a crucial element in the improvement of urban areas. If urban areas were just left to build and build without taking care of public transport, then what would develop would be slums and shantytowns in enclaves of prosperity. The parent company thought transport is a big issue: What is the form that transport should take? They decided that obviously that transport should take if possible the form of a rail based street running but simple form of public transport.”

Social/Environmental Commitment

“One of the hallmarks of our business has been candour, and almost a sense of adventure in the shareholder who supported us, ... many of them have come to us because of the nature of the venture we are involved in, they all share in the sense of struggle and worthy purpose because all of the things we are trying to do are conserving of resources, respecting of the human factor, Schumacher type concepts, economics as if people mattered. We are almost following through by engineering as if people mattered as well.”

Balancing Financial & Social Objectives

"In the end we have to show that the products and services that are coming out of our engineering work are going to yield more in the way of financial return than the cost of providing them. We have had to qualify everything we have done right the way along the line to show in the longer term – and this is the key phrase, the longer term – that this is going to pay off and produce customer appeal by enabling the same job to be done more economically than with conventional technology; that a serious group of engineering companies, the supply chain, will be sufficiently attracted to the idea that in the end they are going to be selling their products and components to the equipment manufacturer, which is Parry People Movers."

"I don't think we have ever been prepared to compromise. We have a certain set of absolutes. ... We have never tried to eliminate the human factor. We believe that what we should be doing should enhance skills and bring forward the talents of people. ... We feel that labour is an asset not a cost. Another absolute is environmental sustainability. We have never taken a decision in the design and development of our product range that has compromised the potential for conserving energy and conserving the environment."

Investment rationale

"I think going to equity as the main source of finance has to be because it suits the courageous. People, if they are going to be involved in enterprise, particularly an innovation starting from nothing, and turning it into something that is going to be a major factor in public transport, the risk is so great that the shareholders and supporters have got to have a bit of vision and a bit of courage to stay the course."

"There is too much of the investment market that is looking for large paybacks on relatively short time horizons."

"The company first raised capital in 1992 when issues of climate change and environmental pollution and conservation were very much for the brown rice and sandals brigade. It was not on the lips of many journalists or politicians. Whereas now you will find that all three political parties have signed up to very strong environmental policies. So the world has very much moved in our direction. Quite a lot of the interest in buying shares in our company will be based on the fact that the general market will assume that the environmental and sustainability questions are going to be more important rather than less important."

Effect of listing on business

"In the membership of our board of directors, as we recognise the thresholds and barriers with regulation in the railway industry, we have had to bring in heavyweight expertise... These have all come on board the Parry People Movers board of directors as non-executive directors but, like me, they are also a little soft in the head and prepared to take a very long view in that they do not collect any fees, because they believe in the longer term business sense of the venture, in that it is going to be many years before the thing can turn around and start issuing dividends and goodies to people on the board."

"I like the original proprietors of PLUS Markets because their approach was very much that they would help bring people in and help do the things involved in raising capital and measuring the value of the company in the form of a share price. We thought that that was valuable."

"I thought that if I am going to raise equity from small shareholders such as friends and family, and even people that do not know us at all, to have a quoted share price would, from my point of view, give me a clearer conscience because they are not having a worthless piece of paper."

"We have found that some of the people who came to us entirely as a name, who became a shareholder, as time has gone by we have got to know them and they have become real friends to the company... The greatest strength of what I have been able to do in bringing the company forward has been able to attract shareholders, because they have been much more than just providers of finance. They have been providers of ideas and connections, encouragement. An entirely good experience."

Advisor representation

"We did have one episode with financial advisors and we felt that they were, in the process of due diligence, tying themselves and ourselves up in asking so many questions it was becoming a very expensive exercise. It was not very good value for money."

Valuing the social mission

"Very often when we went to conventional sources of capital, like venture capitalists, we never got that far, because we found that the thrust of their interest seemed to be that they were looking for positions. They were either looking to sell out to somebody or something that would produce spectacular short term yields. We found in the normal capital market very little interest in the long term, traditional building up of a business based on good

research and development carried through to testing and market production.”

“You can’t reflect social value in the share price, but it might well have helped in the motivation of some of the people who bought the shares. Every document that the company has ever issued underlines very clearly the social, human, environmental, and conservation objectives of the company, and I can tell by the character of many of our shareholders that they hold this as very important for them.”

Creating a social capital market

“I am not very clued up on the mechanisms for a social capital market. We tend to be a Black Country company focussed on good engineering and following our environmental agenda.”

“Yes, we would definitely consider listing on the exchange.”



Piers Linney
Managing Director
Key Homes

Socially responsible property development company providing shared ownership housing at sub market cost for key workers, low to medium income households and public sector employers. Also a provider of high quality, well managed housing to local authorities and housing associations with the aim to improve the standard of living of occupants compared to the housing sourced from the traditional private rented sector.

Key Homes is undergoing a PLUS markets listing

Business Objective

“Key Homes seeks to fill the gap in the market between social and private housing providers, and focuses on providing (a) shared ownership housing with a sub-market rent for key workers and the intermediate housing market and (b) leased housing to local authorities and housing associations. We offer both affordable homes at subsidised rents for people on low to average incomes and also the possibility to buy a share of the equity in the home.”

“Key Homes will have a mixed portfolio of leased properties and for sale residential properties. We are different from other private sector property developers in that we take the long view of the property market and do not aim to sell units outright as quickly as possible.”

Social/Environmental Commitment

"This is a business and it has to make money. However, It also generates social value. Access to affordable housing is now a key social and economic issue. We offer more access to the housing market. Our leased housing model ensures that occupants enjoy a higher quality of accommodation compared to housing provided by individual private landlords with a short term profit motive. Key Homes is an example social business that answers the question: "How do you create a business with a market model that also is socially responsible?"

"By providing more housing choice and making housing more affordable, the aim is to enable households to live and work where they choose rather than being forced to the outskirts of towns and cities for financial reasons where they may have fewer social connections. This assists with the creation of sustainable communities."

"The social purpose is very important to potential housing association development partners when they are considering partnering with a traditional developer compared to Key Homes. We are able to work with partners to create more mixed communities rather than developments that feature a required element of social housing and the remaining housing sold in the open market "

Balancing Financial & Social Objectives

"There is no trade-off between financial and social in Key Homes. Key Homes came about because I spotted a business opportunity in the market. In order to attract institutional investment in residential housing, we are effectively wrapping residential property in commercial property like lease structures. For a business to be sustainable and for 'social businesses to thrive, they have to be able to at least compete with the private sector's bottom line. Investment is difficult to attract and sources are limited if investors are expected to accept a below market financial return in return for social value creation. It must make money as a business and generate a return for its investors. KH is a for-profit business first, which generates social value."

Investment rationale

"Key Homes's capital needs are largely determined by the fact that it is a property company: it is hugely capital intensive business. It also offers an interesting proposition for investors as it combines assets with cash flow generation and provides a new residential investment opportunity that has similar characteristics to commercial property investment."

“Key Homes is in a “chicken and egg” situation with regards to capital raising. One of the largest AIM advisers told us we could raise £20m for the business but only if it had a pipeline of deals. Unfortunately KH cannot line up deals without first accessing some capital to fund working capital and/or to pay for options on properties and land.”

“The listing process is being finalized at the moment and we are firming up the initial investors. Although Key Homes is a social business, from an investment standpoint, the social purpose is secondary to the business model and is listed as the secondary key selling point.

“So the social objective is important to Key Homes and its board, but it isn’t the driver. Social business’s that can create both financial and social value could pave the way for a material increase positive Socially Responsible Investment (SRI) by institutions instead of negative SRI investment strategies.”

Effect of listing on business

“We are listing on PLUS Markets to raise working capital, increase the company’s credibility and to put in place a proper structure and corporate governance. Then we can say to local authorities who want to contract with us: we’re an established PLC and that we have capital, a corporate structure, transparency, access to further capital, a strong board, proper corporate governance and even a share price. Key Homes is about scale and the aim is to raise up to £1 billion in debt and equity and develop a portfolio of 10,000 units across the UK.”

Creating a social capital market

“My background is in law and banking in the City and it was important from the outset that Key Homes could raise material equity and debt finance. Many people that have established businesses with a social aim have a background in the social or charitable sectors and this can lead to a different approach. The Key Homes board represents a blend of private sector and social sector experience.”

“There could perhaps be a place for it, but social businesses have to compete with the traditional private sector for capital and a fund manager or debt provider has to be confident that an investment in Key Homes will provide adequate returns for their shareholders and pension or policyholders compared to another traditional private sector investment.”

"In some social businesses there is a clear trade-off between social and financial return, so money spent to support a social mission has a negative effect on bottom line. For the time being, the markets are focused on the return on capital. Only when there are large social businesses that are making a difference are things likely to change. As with Key Homes, a social business can enter an existing market in an innovative way by re-engineering relationships between certain interest groups."

"An efficient capital market requires scale and liquidity and reaching critical mass is very difficult. Many new European markets have failed. The market must also have institutional support before those companies listed on it can raise capital. Otherwise, you would just create a matched bargain trading service. Also, it could be an interesting idea but who would make the investment to make it happen if a return was unlikely for a long period of time, possibly running into decades?"

"Who would decide whether a business could list on the exchange? What would be the defining criteria of these social businesses?"

"Wouldn't it be better to create a subset of PLUS Markets or AIM for businesses that have a social aim? The infrastructure and institutional support already exists. Is there a need for a separate market for social businesses?"



Jamie Hartzell
Chief Executive
Ethical Property Company

Develops properties as centres for charities, co-operatives, community and campaign groups
Turnover 2005: £1.6 million

Alternative share issues in May 1999 (£1.72m) and September 2002 (£4.2 million)

Business Objective

"We are offering socially and environmentally managed property to socially beneficial groups."

Social/Environmental Commitment

"It's a triple bottom line business and they are all equally as important as each other. ... If we start looking at non-socially

beneficial groups, it would jeopardise our tenant base. If we start not to manage property as environmentally, it would jeopardise our investors and our tenant base, and we would make less profit. They work together. They should not be thought of as one being a trade off against the other."

Balancing Financial & Social Objectives

"By doing a share issue your perspective is effectively a contract with your investors. You are saying what you are going to do and the investors are buying into that. You set out your stall. As long as you have done it correctly, and the model works, there is no intrinsic conflict. You explain very clearly to your shareholders what it is that you want to do and why, and they are then buying into that. As long as you continue to do that successfully, they are supporting your objectives rather than working against them, because that is the basis on which they came into the thing in the first place."

Investment rationale

"What we were trying to do was extend the investment model because we knew that it worked, because it worked for us as individuals. So it was always going to be equity because we already had equity by founding the company with our own individual properties as the starting point."

"Every significant business has a mixture of loans and equity. It is where any decent sized business would end up. I suppose we could have been a non-profit organisation, that might have been our alternative, but I am not sure how we would have raised any money."

"We don't want to have too much institutional investment because we do not want to have too many large shareholdings dominating the company who are not themselves directors of the company."

"The difficulty for institutional investors is not so much buying into the social mission as being able to make an investment in a company such as ours under the terms of their investment regulations or policies. ... I don't think they had any difficulty interpreting the social and environmental mission. In fact, I think they were only too pleased to have something that stood to deliver a bit more environmental benefit than Vodafone."

Effect of listing on business

"We knew that if we were to grow the company we would be, as individuals, relinquishing control in terms of shareholding, though

we would remain directors of the company. I can't see that there is any alternative to that, really. Any company that comes of a decent size through external investment is going to see some relinquishment of control."

"We have to act in the interest of our shareholders, but we are not going to be displaced by our shareholders if we carry on doing a good job of running the company."

"Issuing shares can be very expensive, but we seemed to keep the costs down very well, and they were fully subscribed issues. So we were able to grow the business significantly. It would have been easier if it wasn't such hard work, I suppose. Or quite such a complicated procedure, but it is never going to be a less complicated procedure. It is complicated."

Advisor representation

"As we get bigger, different advisors become more appropriate than others. Initially we just inherited them historically. The first company accountant we had was my personal accountant... We just picked people up from where we knew already, with whom we had a working relationship with already. And then went through a tendering process to replace them with others... Triodos were the sponsors for the first share issue."

Valuing the social mission

"The share price doesn't include an element of social value. We just priced the shares at a netasset value per share originally... We built a discount in slowly over time. But that is just to bring us closer to the way property shares are valued on the FTSE."

"We surveyed our shareholders and compared the results. There are only two institutional fund managers, and their reactions were pretty similar to the other individual holders. Except they felt more strongly that the company should give a good financial return that ranked alongside other commercial property companies."

"The truth of the matter is that we are not benchmarked against anybody, because the institutions have not invested in research into us. They just regard us as an unlisted thing on the side. ...I have tried to get institutional investors to do some research into us. ...I just want them to treat us like they treat everyone else, but maybe there is a psychological barrier to doing that."

Creating a social capital market

"I think it is a good idea. Because there are a lot of people looking to invest on an equity basis, and there is a lot of opportunity for

companies to raise further funding, which would be largely under their control, much more so than some venture capital investment, or the bank.”

“Raising the profile of this form of investment and attracting new investors to it would be important features. Just generally raising its profile is important.”

“I think if it is an ethical exchange there is going to have to be some sort of understanding of what that means and then there is going to have to be some kind of criteria for meeting it... You couldn't have an ethical exchange and then just let anybody on it. It would be nonsense, wouldn't it? There would have to be some form of accreditation.”

“In particular some form of social audit might be obligatory. You may have to be reported on in terms of your performance. It probably needs some sort of prospect for return. You could not just have people coming in and seeing it as a way to get grants, because that would just destroy the whole thing. It needs to have some standard of transparency, good governance guidelines, and some sort of aspiration to best practice, would be what would mark it out. And there would have to be higher best practice standards than you would get elsewhere.”

“I think there is a tendency for people to be a bit back footed about this stuff. ...I think you need to be more front footed about it and say “I know what I am doing, I know it's good, I know why it is good.” ...There is a tendency for people to be a bit defensive, which is not very entrepreneurial really. Just get on with it. We are acting more like government offices than entrepreneurs. ... They are just not being creative and imaginative enough. The market could encourage that by the way it is set up.”

“Why would an ethical exchange be different to anything else? Why would this exchange be different to PLUS Markets or AIM or the FTSE? How does it set prices? What is the appropriate level of liquidity? Who controls it? That is really important. Is it controlled by marketers or the people listed on it? Who profits from it, is it a profit making entity or a non-profit entity? Is there a bid –offer spread? How do you price? How do trades actually take place? Do they take place on a matched basis? All of these are important considerations.”

Phil King

(Formerly) Financial Director
Cafédirect

UK's largest Fairtrade hot drinks company
Turnover 2005: £19.7 million

Alternative share issue in February 2004

Business Objective

"With the ending of the International Coffee Agreement in 1989 and the subsequent collapse in coffee prices, the founders wanted to buy direct from the growers at a fair price to give them a price that would at least cover the costs of production. That was the initial impetus for the company to be set up."

"Cafédirect always intended to follow fair trade principles. The Fair Trade mark that is applied to all of the products is a form of third party authentication that we do follow at least the minimum fair trade standards. But Cafédirect has always wanted to go further than the minimum Fairtrade standards. We have our Gold Standard policy and that requires that we do pay more than the minimum fair trade prices."

"We look at producers particular needs, and define what is required with them, and then instigate training and development programmes with them. Last year we spent £574,000 on our Producer Partnership Programme, and this has been growing each year. There are ways in which we differentiate ourselves and go further than the Fair Trade principles."

Social/Environmental Commitment

"We try to operate in an ethical way. We are in a broader sense a social enterprise, because I think broadly that social enterprises need to make a profit in order to be sustainable.... We see ourselves more working towards trade justice as the thrust of the business. The concept of trade not aid. By trading fairly with the producers we hope to develop a sustainable business."

Balancing Financial & Social Objectives

"There are two imperatives: one which you would call the social imperative and the other is the financial imperative. It is always a balancing act to get those two right, but we do not focus on one at the expense of the other. They are both equally important."

"We have no hard and fast guidelines in terms of how we define the return each year. But what we are looking to do when we plan

our budgets each year is that we are looking first at the imperative to improve the livelihoods of the growers we work with.... Our budgets have to be based around increasing volumes and also allowing for the investment in the growers' organisations, after that we are looking for a minimum return or minimum profit margin to keep ourselves sustainable."

Investment rationale

"The reason we needed to raise finance was that we were growing rather too quickly for our own good. You sometimes can do that because you grow so fast but you are not generating the working capital to feed the business, and that is what was happening."

"We felt that if we were going to be successful, why didn't we just go straight to the market and raise funds from the public? There were a couple of other motives for doing that: one of them was that the founders had always wanted to dilute their shareholding and get more people involved in the ownership of the company. Long term what they saw was that Cafédirect should be owned, not only by themselves, but also by people who drank coffee and tea, people who grew the coffee and tea, people who processed the coffee and tea, people who worked in the company.... That was a quite a critical part of the thinking to go for a share issue."

"When we were going through the share issue we did approach a number of institutions that were interested in investing. One thing the founders put in place was a limit on the number of shares that any one person could own, so it limited the ownership to 15 per cent of the company, which would prevent anyone buying a large proportion of shares and trying to influence the way we operate....What that means is that we then can't list the shares on a public exchange, which then means that they are not as liquid as they might be, and this is the concern of a number of institutions. They felt that if it wasn't listed on a public exchange there might be difficulty in disposing, if they bought a large shareholding, as and when they wanted to. That was the major concern."

"We encountered some institutional investors that quizzed us, ...and there was a feeling that because we were calling ourselves an ethical company we weren't seriously wanting to make a profit. If you call yourself a socially responsible company it seems to imply that you are not really bothered whether you make money or not. That was a bit of a hindrance that we had to argue against or stand our ground on.... They thought of us as a charity looking for charitable donation rather than investment. That was a negative side when we were trying to interest people in investing."

“Very few of the institutional investors bought shares. I think part of the reason they were a little wary was the lack of liquidity. They couldn’t see sufficient liquidity in the shares.”

Effect of listing on business

“The concern that ...we...had, was that you could find yourself more concerned about the financial returns, so we were very careful when we launched the share issue to say to people that this is about the social return as well as the financial return.... our intention was to go for long term growth rather than rapid short term growth at the expense of long term sustainability.”

“We realise that there is a cost to capital, and the cost will be the dividends in the future. There is a recognition that dividends will need to be paid, and that the capital value of the shares should rise so that the investors do get some returns, but it is not going to be dramatic, and it is not going to be immediate.”

“Once we went to a public company what we wanted to establish was that the level of ownership that you had did not give you access to the board. ...We appointed people to the board to be representative of our various stakeholders rather than particular owners....It was quite a different board structure that we had based more on representing stakeholders rather than individual shareholders.”

“We found that during the year of the share issue we increased our sales by 27 per cent. I think part of the reason for that is the amount of publicity we generated from the share issue...It gave us a lot of publicity, increased our sales, and raised us the £5 million, so it worked very well for us. I think that is because we took the view that this will be a marketing opportunity, and approached the share issue as an integral part of our marketing plans.”

Advisor representation

“Since the company was formed we have used Triodos Bank. They had an advisory arm that could help us in a public issue, and so we decided to use them because we felt that they had shared same ethos as us and would understand the concept that we have of the social and financial return.”

“When we spoke to other financial institutions they found it difficult to understand how you could marry a social return with a financial return. So we were looking for someone who understood that and would help us to put that across to potential investors, because we felt that was quite important.”

Valuing the social mission

"We did the valuation in a fairly conventional way looking at our future prospects and looking at our current profitability and future profitability and applying a multiple to earnings looking ahead. But from the founders point of view, once we had done the calculation, it really came down to whether they felt comfortable with the valuation of their shares and whether they were under or over valued."

"Each year we will review the future and where we think the company is going and working with our advisors establish a value for the shares going forward. Because we are not listed on an exchange there is no one making a market, therefore there is no one putting a price to the shares, we work with our advisors on putting a valuation to them."

Creating a social capital market

"...It requires significant time and money to build up an exchange to the point where you have lots of people who want to join it, and you have people to come and buy and sell."

"If there was someone who was willing to try and develop an equity market for ethical investing, then we would certainly be interested, yes."

"When we talk about a social capital market, what needs to be understood ...is if you are trying to create social capital as well as financial capital, then investors need to be aware that the financial returns are not going to be quite so good, as they might be otherwise."

"I think there needs to be understanding of what the underlying principles of the companies are. I think we also need to be clear what we mean by social enterprises because some companies seem to be defined as social enterprises because of the products they make, others are defined a such, because of the way they are run."

*"The other issue is how you set the price, and control the pricing of the shares, how you can minimise speculation in the shares. This is what we wanted to try and avoid with our own shares, ...that there isn't the potential for people to make speculative gains. The price of the share should reflect the underlying value of the company and its long term prospects, not short time supply and demand or short term fluctuation in profitability."
I think that it comes down to critical mass and whether you can get sufficient companies. Even with markets like AIM and PLUS*

Markets the amount of liquidity is pretty low...I would think there would need to be a large number of companies to make into a sufficiently interesting market to attract people to use it."

"Another of our concerns – we wanted people to be able to buy and sell the shares without huge costs. We were looking at relatively low costs. That could involve automatic processing in order to hold some of the transaction costs down."

"I know there was concern about how social businesses raise funds, but I think that some of the issues are the same for any businesses trying to raise funds. Most social businesses are of a certain size, and it is the size of the company that has most difficulty in raising funds."

"Sometimes social enterprises need to be possibly a little bit more ambitious in what they see as being their long term future. ...You do get the feeling that some people are happy with the size of their businesses as they are, and that can be a disincentive for someone to invest, because you would want to believe that you are investing in something that could grow. If you stay still, there is a possibility that the company will stagnate and not have a long term future. I think that can sometimes work against social businesses unless they are more positive and indicate that they can envisage growing bigger."



Ella Heeks
Chief Executive
Abel & Cole

Home delivery of organic produce
Founded: September 1988
Turnover 2004: £6.8 million

Unlisted private company

Business Objective

"We are an organic home delivery company, so we sell a range of organic foods via phone and website, which are delivered to people's homes. The goals of the business are pretty wide ranging: above all to demonstrate an alternative and sustainable way of retailing food."

Social/Environmental Commitment

"It is an intrinsic element of the business – partly because the core service of the business is environmentally and socially beneficial. It

leads to the expansion of organic farming in a very direct way and also reduces food miles in a very direct way."

Balancing Financial & Social Objectives

"I have never found it to be something where there is a conflict. There are many examples where we have found that by doing the responsible thing socially or environmentally, we have saved money. We do have budget allocated to staff welfare and community projects where we do not expect to generate any benefits for the business. But in terms of the environmental side things like waste management, it usually pays for itself."

Investment rationale

"The business is privately owned. There is one major shareholder, with small shareholdings amongst some of the key staff, and has been funded by private risk – one person – borrowing from banks. That has been driven by two things. One is a very strong wish to maintain the independence of the business in order to allow ourselves room to spend on the social and environmental initiatives, and to have control, in particular, not to have to compromise on those areas. The other reason is that there was simply no other option when we were starting the business. In its early years when we actually needed finance, there was absolutely minimal interest in financing it. It was a struggle. Part of the reason that we took the risk ourselves is that we were the only people willing to do so."

"We only approached banks, because we did not want to compromise the ownership. So perhaps we could have taken finance from a venture capitalist, but the other side of it is a time issue. ... In those early days, every day counts for so much; you are working flat out. Partly it was that there wasn't the time or the skill in the business to devote a significant amount of resource to researching possible funders and approaching them and negotiating with them."

"In terms of pure decision making processes – having a board of two people rather than twenty and without the involvement of an external financier has meant that we were able to experiment more and make very quick decisions when we need to, and we have really enjoyed that."

Effect of listing on business

"I think the cons would be the process of the float and the maintenance after that, maintaining a large shareholder base, and the diligence and various processes we would have to follow with that structure of ownership. Also the level and amount and

quality of communication that would be required with a diverse body of shareholders. Having looked at the Cafédirect example, I think listing is very labour intensive thing to do, and could create another set of stakeholders alongside our customers that we would need to treat at the retail level, who would require that level of information and that level of care."

"The pros would be that it would give our customers an opportunity to become involved with the business, which I think many of them would love. It is something that would be consistent with our values: to open up ownership to our customers. I think it is something that would bring good publicity to the business."

"Once ethical businesses become successful, there are lots of people with ethical funds to invest that are struggling to figure out where to put them. So it's not difficult to come across someone who would love to buy a chunk of the business. Venture capitalists are out there, and make it relatively , whereas the option of a public listing would require a huge amount of proactivity."

Valuing the social mission

"Because we invested on our own, our values are the same as those of the business. Having created the business and defined its goals there is a perfect match on that front.... At the point where the business is owned by us (as it is now), there is going to be perfect congruity between our values and the pressures we are under. The further we move away from that, the more pressure there is going to be on us to do things that don't quite fit."

"In some ways I think relative to other sources of investment an AIM float could produce less pressures than other sources. I would be surprised if individual investors who came to us through AIM weren't partly investing on the basis of their values, and only partly on the basis of financial return. But maybe that it is a little idealistic of me."

Creating a social capital market

"I wonder why that would be necessary given that we already have AIM. I do wonder what the benefit would be of a separate market. There are overheads involved of various sorts, and I would struggle to see the benefit of separating it out."

"I think investors and investment managers are very aware of ethical criteria these days. It is quite normal to see ethical differentiation between stocks that are sitting on the same market. I do not think they need to be on a separate market from that point of view."

"I suppose there would be the benefit that you would filter out investors and reduce the risk of comparison between super profitable, totally unethical businesses and the opposite, if they were sitting on different markets."

"There may be a status thing attached to being floated on it. That it would be a mark of ethical credibility, and I suppose that would help some businesses. But I think that AIM carries a certain authoritative ring to it anyway."

"The consumer market isn't going to be sufficiently aware of the difference between the various ways of floating for the benefit to the brand to be particularly strong. To be on an ethical market, I don't think that is going to affect the brand with the consumer very much."

"You worry about the overheads, if this is being centrally researched and managed: What about if somebody floats on an alternative ethical market and then loses some of their ethical credentials? I just can't see how the oversight would work, really."

"My experience as an investor is that it is very labour intensive to research potential investments, especially if you are going to apply positive ethical criteria rather than just negative. ...I think there is a huge information barrier and I do not know to what extent that would be resolved by grouping social purpose businesses together in a separate market. ...Essentially a lot of SRI fund managers will sit there with the FTSE 100 list and filter out the arms companies and invest in the rest. And the reason why, is that there aren't that many who have the resources to do the research. They would have to do that anyway, whether or not you placed it on a separate market. In that sense I think the benefit of a separate exchange might be limited."

"I think also if it wasn't a separate market, but just a mark, then companies could lose their mark if they slipped on the criteria. I think that is more viable. I just would question the extent to which the investors would trust it or use it."

"Enlisting people into a system like that, given that it is by no means the obvious option, by no means the cheap option. There are quicker and easier ways to raise finance for most businesses, even ethical businesses. So there would have to be some incentive. It would need to be quite well marketed to the potential participants. I think it would be a real challenge, because of course it would also need to be marketed at the other end to the potential investors."

Gordon Roddick,
Co-Founder and Social Investor
The Body Shop

Natural skin & haircare products
Turnover 2005: £419 million

LSE (BOS) listed in August 2000
IPO on alternative market in 1984

Balancing Financial & Social Objectives

"I was chairman of a company that was pivotal to all of this, the Body Shop....Social and environmental objectives were the whole motivation behind the business The notion of combining social good with good performance on a capital basis is not new to me, because it is a long held belief that this needs to happen for this industry to be truly strong."

"As long as you have control of the company, the conflict between social and financial objectives generally is not an issue. It also has never been an issue with some of the larger institutions like Prudential and Fidelity in the USA and others that have always believed that social and environmental objectives were fine."

Investment rationale

"We financed the business in combination with bank borrowing and eventually going on to the London share market."

"There was a lot of interest when we floated. First of all it was a female entrepreneur, as my wife took the lead in the market. It was interesting, as there were very few women that had any kind of business profile. ...Investors probably emphasised that more than the social and environmental objectives. All they were interested as far as the environment was concerned was what would it have to cost."

Effect of listing on business

"The IPO was a very small float on the unlisted securities market, which no longer exists, it is now called the AIM. We did not have to change anything because we were only floating 15 to 20 per cent of the company. And so it was very much on our terms."

"We subsequently floated more of the company as the years went on. The business is now 30 years old. We subsequently diluted and raised more money and had rights issues, had other issues. We moved deeper into the system. It was probably a mistake. We

were probably much more political than just social. Probably as quite highly politicised entrepreneurs we were not suitable to be a public company.... Frankly I would not do it again, no."

Advisor representation

"Frankly at that point – I think it was about 1984 when we floated – we did not really care what the advisors were saying. Well, because we were just interested in carrying on business and furthering the aims of our business. I mean the advisors frankly are just looking after themselves and looking after the size of their fees and what is the next deal they can do. As soon as they are done, they are done, and they are looking to their next deal. The last thing on their mind is the social and environmental value creation, all they were interested in was the bottom line."

Valuing the social mission

"It is a very subjective view. It is a very individual answer, subject to view on what I see as the strengths of the idea, and even more importantly the strengths of the people running it. I have seen good ideas with mediocre people running it, and I have seen mediocre ideas that have come to fruition through good people running the business."

"Obviously, investors have to eat as well as investees. So you can do some at a lower rate of return if you think they need help over a hump. It is purely a question of judgement on what you think the businesses will bear, and what you think is there as well."

Creating a social capital market

"I am not sure it will work. Unless it comes out of market demand, I do not think it will work. I am not sure the world is ready yet."

"I am not a believer in the public markets because they are almost invariably driven by one motive -- and that is the profit motive. I am not quite sure where and how you can measure the social return. I would advise all businesses that are interested in being a social business to keep away from the current market."

"Whether or not you could produce a market – there have been numerous attempts. The problem has been the number of deals they can get in order to keep themselves going. In order to do that, they generally have to compromise. And the problem is that it ends up if you don't drop hand grenades, or Shell, arms or tobacco then you are suitable for social investment. They become highly diluted because of the need to attract more deals or find homes for their cash."

"The principal limitation is the sheer volume. The number of companies involved in that kind of thinking social purpose businesses is so limited. They are all down at the lower end of the food chain. It is impossible to rate Shell or BP in that kind of thinking. It is impossible to rate almost any of the bigger companies."

"There are probably a number of big businesses that are showing interest: ABB and Siemens and a number of others. They have begun to realise that the world is changing, but whether it will change quickly enough, I am not sure. When you have Walmart and now Tesco running around the world driving down prices, slavery is alive and well, and growing at an alarming rate. All justified by this wonderful word: competitive advantage. Which is basically an excuse for anything that they want to do."



Jonathan Shopley

Chief Executive

The CarbonNeutral Company

Carbon offset, consulting and risk management

Turnover 2005: ~£2 million

Undergoing AIM listing process

Business Objective

"Our objective is to stimulate action on climate change on a pre-compliance or beyond compliance basis, not necessarily driven by regulation, on a voluntary basis. Our mission is to address the issue of climate change by providing services to predominantly business and members of the public."

Social/Environmental Commitment

"Although we are very strongly focussed on an environmental good, an environmental service, we see ourselves as a business, a business that provides an environmental service aimed to do good business and do good.... Our core objective is to redress climate change by engaging people in early positive action, so it is our core purpose. But we are structured, and describe ourselves as a business."

Investment rationale

"Our experience has been that the financial model makes up about 80 per cent of the interest in the company. And the fact that we are focussed on carbon, carbon management, climate change and environment is an issue, but we are not positioning ourselves

specifically as a social enterprise. Although I would say that Triodos' interest in us, and their investment that they made back in 2003, was driven largely by the fact we were out there with a core purpose focussed on looking at the climate and renewable energy space."

Effect of listing on business

"In the sense of addressing climate change listing should be positively reinforcing because we would think that the markets would like us to grow and be profitable. As we grow and are profitable we will be providing solutions to climate change through our services. But I would say that social objectives of social enterprises have a longer term view than we sense the market has."

"It will force us to put emphasis on how we see the mechanics of the business model actually working and give some emphasis to substantiating that. But beyond that I do not think that it poses any more specific challenges other than that we need to focus on the guts of the business and the vision of where we are going and what we will do into the future is an important starting point, but it is not the basis on which a decisions are made."

Valuing the social mission

"Because it is a new market, our position is quite unique, and our growth factors are defined by a number of factors over which we can have only indirect control. There are very few comparators to what we do that we can point to similar companies with valuations that have been established in the market. Those are all the issues that we are currently facing as we position ourselves in the marketplace."

"With certain private investors you can sometimes find people really being motivated by their vision of a society where climate change or voluntary action is primarily or very significant contribution to business activity and they pay more attention to that."

Creating a social capital market

"I can see the benefits to having a mark – a set of companies that are identified as having strategies that address key social and environmental goals in a good way, but I think in the end it does come down to the fundamentals.... I like the recognition that companies in a sector where there are social benefits being returned over and above profit streams have some kind of mark, some recognition. But I would not want that to necessarily replace or displace or try and create a different investment model that

would be quite difficult to do and be successful in. My experience is that the SRI sector feels this as well, in the sense that they are struggling really hard to prove both that their investments are profitable in conventional terms and good in a wider definition.”

“I think, in the past, there has been a tendency for the environmental, or social or CSR movement to slightly ghetto itself, create groupings which set the sector apart in a way that means we are less able to influence the mainstream.”

I think that there are two things that could probably be usefully strengthened: One is the market’s understanding and knowledge of how to value and understand the role of social enterprises. I think that would be helpful some education, some set of processes and market makers that are able to communicate the fundamentals and the wider benefits of the ethical business sector. On the other side of that I think it will be useful to understand and clearly communicate what constitutes that kind of a company. Those two factors would be useful. In terms of would it help to have investors line up with funding specifically for this sector: potentially not. I think it is awareness and understanding that would attract funding rather than just creating a pool looking for business.”

“I think the sector really needs to make its case on its own, and that could be helped massively through a better understanding of how social enterprises emerge, and which markets they are tackling and how those markets are expected to grow.... The challenge with any new enterprise, whether it is environmental or socially driven, is to build understanding of the market and the market potential.... I do not think we can necessarily expect that the operational strength and strategic direction of the company itself would be looked at in any way different to fundamental investments.”

Juliet Davenport
Chief Executive
Monkton Group plc

Supplier of renewable electricity
Turnover 2004: £4.0 million

PLUS Markets (MONK) listed in September 2004

Business Objective

"Good Energy is a renewable electricity supplier. Our objective is to provide low carbon solutions for individuals and businesses in the UK. We believe every person in the UK has the right to make a difference in terms of the environmental impact of climate change, and we try to provide simple products in order for them to do that."

Social/Environmental Commitment

"I would place our business closer to an ethical or environmental enterprise, rather than a social enterprise.... The core to it is that the company's core beliefs are protected, although shareholding is important, but within that the corporate belief is protected. That is what differentiates between the main markets, where the shareholder is king, and where the stakeholder becomes as important as the shareholder."

Balancing Financial & Social Objectives

"Rather than board meetings we have what we call Gaia meetings. Essentially the management team reports to the core ambition of the company. It also reports on a financial basis as well, because the financial becomes a mean to an end, so the financial side of the business supports the core social ambition of the business."

"In terms of ownership, we would always have to think very carefully about allowing external parties to buy a controlling stake. To date we have limited the amount of equity we have offered to external individuals. If we were to offer a greater portion, we would have to think carefully about revising the articles of the company in order to protect our ambition and what we stand for. We would require a structure that would protect our interests. On the financial side we would extend the imperative to protect the environmental ambitions of the company. It is a difficult balance to strike."

Investment rationale

"For the first structured investment, ...we wanted to stand on our own two feet, and grow the business a little faster than we

had historically, so that is what we did. We raised some money to do that, and we also wanted to purchase a wind farm at the same time. We had three key objectives: a form of independence, investing in our marketing, and investing in a wind farm. That was the core objective of our first equity offering. The second one was very similar, and it is likely that we will go for a third one which will probably have more new products to support.”

“We did look at what was called EtheX. Our offerings were at first unlisted, and then we went to PLUS Markets. We did not use PLUS Markets initially to raise the finance. We did it the wrong way around in some sense. We used PLUS Markets because we wanted transparency in the share price. One of the problems was answering questions to shareholders about what was the share price, and explaining the difference between the issuing price and the share price. It was quite a complex process. So listing on PLUS Markets made it a lot easier in terms of transparency. We were finding that the majority of our customers have not sold shares, but obviously there are situations in which people unfortunately pass away, or need to sell shares because they have a liquidity problem, and PLUS Markets facilitated that process.”

Effect of listing on business

“One of the things that we did, because it made sense for the amount of money we wanted to raise, we actually went out to our customer base. ... Historically we had always been asked by our customer base whether they could buy shares in us, so we put a vehicle together that could allow our customer to buy shares in us. We felt that was an effective way to allow us to give something back to our customer base, and being able to share in any growth in the company, but also a way that the customer base, which we knew was already aligned with our social ambition as an organisation. It meant that we did not have to move to far away from that in terms of issuing a prospectus.”

“We have to issue more reports now. But we have always had very strong financial management and financial input at a board level...So the reporting levels have not changed a lot. In terms of public awareness, we write to our shareholders, but then we write to our customers a lot as well. We have a listing on PLUS Markets, and we have to be aware of the information put into the public domain.”

Advisor representation

“In terms of their ethical or environmental awareness, I do not think that financial advisors are quite at that stage. Most do not get the environmental issue. In our case, they probably would not

have been able to do the equity offering without our input into the environmental component of our business. But effectively we did not have to test that, because we assisted them with the offering and because of the nature of our offering to our customer base.”

Valuing the social mission

“We were valued according to normal market indicators. We did not increase the value to capture the environmental benefit we bring. The next stage will be to capture the value of our name and the core ambition of the company, but this has not been done previously in the valuation.”

“Not a lot of people understand our business whether financially or in the core ambition. We need to work on this in order to get a proper external valuation of the company. In terms of the shareholder base, it primarily consists of individual investor holdings that average £1,000, representing 10 per cent of our customer base. However, if we are going to demonstrate our value, we need to speak to a wider audience in the City.”

“The City is, for the most part, sceptical, and operates as a sort of small shop, where they are focussed on a topic of the moment, and where the talk in the industry can bring value to a share price. They are largely very cynical about environmental or ethical value. They like technology, but they do not get the softer side. They are quite money driven, and that is the main objective of the market. For us to enter into that market and get credence is quite hard.”

Creating a social capital market

“I think this is an excellent idea. From a feasibility standpoint, if you can work out the issues of accreditation, appropriate indicators, what needs to be developed, and how (on what basis) to allow people in – whether they are accredited or not to trade into the market.... The absolute crux of the matter is the process of accreditation.”

“Pension funds and other funds can invest as a means of balancing risk. From a SEE perspective, these businesses tend to be lower risk and are structured in such a way, as to eliminate the big risks of unethical investment. The risks of arms trading, etc are not present. People could buy into this as a defined market, which could be seen as lower risk.”

“You would require the support of 1-2 large financial institutions to provide credibility as well as the requisite liquidity to make it work.”

"In effect, we listed on PLUS Markets because of convenience. If there existed a social, ethical and environmental exchange, but with a simple basic level of service, with the structure of something like PLUS Markets, then we would be happy to list on this exchange."

"The problem with PLUS Markets is that it has no unique selling point, and therefore it suffers from problems of liquidity. I have always thought that it should be linked to AIM, so that early stage businesses would list on PLUS Markets and then progress through to AIM when they are larger. It is similar to the electricity market. You either have to be big to survive, with the benefits that this brings, or in the case of the majority of small companies, have a unique selling point. No one can survive in the market competing on the basis of price and service. In this case, the exchange would have to have a unique selling point."

Mark Mansley

Strategy and Communications Manager
Rathbone Greenbank

Ethical investment management services for private clients, trusts, pensions, and charities

Investment Objective

"We manage approximately £200 million of funds for a variety of ethical clients. They are all in individual accounts so most of those clients will have their own investment objectives, typically whether balanced objective, growth or income. They all have their own ethical criteria although there tends to be a core set of ethical concerns most share."

Minimum Market Cap Size

"We find that a lot of our clients want to invest in smaller, more interesting green companies, but against that essentially is that we have to factor in the risk and liquidity issues. But broadly speaking we do invest in smaller ethical companies, we prefer them to be clearly green and ethical.... A lot of our clients like to invest this way, and some are quite sure about how they want to take their risk, and to some extent are moving out of more conventional equities into a combination of lower risk investments such as bonds and higher risk, but more interesting investments."

Investment decision

"A lot of the issues centre around the financial criteria. Obviously we look at that. But a lot is more about the structuring of the issue

and how much we feel we can reasonably put into them. Normally we are pretty clear on the ethics. The sort of things we are concerned about is to reduce the risk. People are not necessarily concerned about making a shed load of money, but they are concerned about losing their money.”

“Liquidity is important. All things being equal we would like these investments to be listed on AIM or a market like that if they can be. Triodos operates a matched bargain basis for dealing with these shares, but it’s not as satisfactory, as liquidity is a bit mixed. What we actually need to do is have...less the ability to trade, and more the fact that the share is regularly being valued that is important to us. A matched bargain basis doesn’t really give you that whereas the AIM does.”

Investment channels

“We get contacts from various channels. Most of the ones we have invested in have come through Triodos. We do see a number of other deals come to us directly or through some of the other brokers. Although it is interesting to note that when we come to the brokers or the nomads on AIM when you get some of the more interesting social or environmental stocks, there has not really been anyone specialising in that area of the market. They are spread out over quite a wide range.”

“It is interesting to what extent have they sold the stocks to people who are interested in social and environmental issues as opposed to the mainstream market. They have not done that as much as we would like. Some stocks which we would quite like to have known about at the IPO we did not hear about until afterwards... And also we do not have the time necessarily to filter through all of the issues coming to market.”

Investment performance

“There is still a lot of caution. To some extent there have been a lot of not very happy examples. We remain fairly cautious on a lot of those. There have been a number of successes and that is good, but I would still generally regard it as quite a risky area.”

“It is risky often because of the small size of the business. There are often a lot of management issues associated with these ventures. They may depend on one or two individuals, they may depend on a market niche or idea... A lot of them do struggle. Some of them would be better if they could be a bit bigger. In terms of being investor friendly is quite different if you are a business with a turnover of under £1 million or a turnover of £20 million, by which time you are of such a scale you can start to actually deal with investors.”

“Often there is a certain hesitancy with some of these businesses to grow. It is a balancing act.”

Valuing the social mission

“I do think there is an issue that sometimes companies don’t – the social and environmental capital that these companies have is not accurately presented. Often it is both that the market does not value that, but also that the company does not present it effectively.”

Alternative structures

“There is a point to looking at whether social purpose vehicles, if appropriate, could have more interesting capital structures where maybe you structure an investment as preference shares where market investors get a reasonable return on investment, but it is a capped return. The way it works in terms of capital structures is – in terms of governance – that as long as the social purpose vehicle paid its investors what it said it would pay them, then their voting rights are limited, but if it fails to deliver financially what it said it would do financially, then it has to face up to the prospect that the shareholders can act to change the management.”

“I think there will be a market for those new sorts of investments. It is interesting to see in the bond market, for instance, in certain areas there have been quite substantial sums of money raised by sectors such as social housing, public transport railways, things like nursing homes – where clearly there is a lot of asset backing. Further amounts of funding are easy to obtain for those social types of businesses. But they have been quite large bonds for structured bonds backed by social housing. We like investing in those because they are generally low risk investments. They also fit with our ethical criteria. There are examples out there. That is an area that has been developed on the bond side in the last five years. ... But they are not the sort of investments you can access through the stock market.”

Effect of listing

“The company may need some change. It may need to be much more accountable to investors. It needs to account that actually there are people that have given it money that they have an obligation to, and that have a real interest in the business... I think some social purpose businesses quite often don’t. They have often grown on a grant culture. Actually the grant culture is – they don’t think of investors as being part of the entity to the extent that a listed company would do.”

Social capital market

"It could be a good idea. The trouble with special markets is that they can succeed or not succeed. Whether it is necessary to have a strictly separate market, or whether we could live within the confines of AIM, for instance. Looking at the CIC, could it list some of its capital on AIM? And if the answer is that it can, do we actually really need a separate market? Because there is a slight case to which investors can only really deal with so many different place to go. Also the infrastructure is already in place, why reinvent it?"

"People looking at social purpose companies tend to disparage speculative investment. But the irony is that if you want to have some degree of liquidity on the exchange, you need a deal of speculative investment to provide the liquidity. If we have long term investment, you won't have that much of an active market. So there is a slight quandry there. If you are going to have an exchange for social purpose companies, where is the liquidity going to come from?... It is a question not of having the money there, but if people just sit on the investment then you do not have the liquidity and if you don't have the liquidity then you don't have an exchange."

"The other option: maybe the emphasis is less on exchange and more on listing, accountability and control.... For instance if the company is willing to buy back its bonds or shares through some sort of mechanism. It could be a tender mechanism or lottery mechanism, it would mean that people could feel that if they wanted to get there money back then there are some other avenues other than selling it on the market.... The pricing system that exists on the market, the share price is really based on the price at which we will buy back shares at rather than any indication of supply and demand. That sort of mechanism may be interesting for unlisted social purpose companies."

"I think where there is a role for the exchange, and it is one of the issues you get with unlisted investments generally, is the effort that is needed in monitoring and looking after the investments.... When you go to unlisted investments, no one is doing the watching other than yourself. It is up to you to contact the company once a quarter or once a month and try and figure out what is happening and what the reporting requirements are. That is where I feel maybe an exchange could help. It may be less of an exchange and more of a listing and monitoring body rather than a place actually selling and exchanging. But essentially one of the things the company can do it report regularly, and perhaps if you are an illiquid company you should report more regularly."

"We need someone else or some other body to do due diligence so that when we invest we know that the various questions have been asked, the various things have been checked and so forth. That is one possible role for the exchange. ...At least to say: well this company has been checked, and its accounts are what it says, the directors have got the CVs they have said and so forth. ... Because otherwise you find, that it is a dangerous place out there. So there is scope for that sort of checking function of a social business exchange."

"The other area that could be looked at would be tax incentives. It has attracted people to unlisted investments. You have got quite powerful incentives for the VCT and the EIS ... They are quite generous but they are quite undirected. There is an argument that if you are doing to have tax incentives it should be done in order to provide the maximum social benefit. It is always dangerous to build a market on the basis of tax incentives, but nonetheless it would be useful to have something more on that area. There is a very strong case it is probably a good idea if these sorts of investments can get EIS type tax breaks, if at all possible."

George Latham*

Associate Director,
SRI Funds
Henderson Global Investors

Henderson manages £1.1bn in pooled and segregated SRI portfolios on behalf of personal and institutional investors

Investment Objective

"I manage the Henderson Global Care Managed Fund and the Henderson Global Care Income Fund. The latter is UK equity income fund with the objective of outperforming its peer group by investing in UK companies that meet ethical and CSR constraints. The fund has a strategic focus on areas identified by the Industries of the Future focus on sustainability. The Global Care Managed adopts the same ethical approach, however the investment focus is on a global balanced fund, allowing investment in a broader range of international equities as well as some bonds."

Minimum Market Cap Size

"We can invest across the range of equity classes from small cap to large cap. We do hold AIM listed stocks, but not many PLUS Markets at the moment. We also hold some unlisted companies such as the Ethical Property Company. We are limited in the

number of small caps we can invest in as we do not want to hold more than 10 per cent of any given company. The Fund also has a designated proportion allocated to investment in small caps.”

Investment channels

“It happens on a case by case basis. Sometimes the investment opportunities are brought to us, and other times we are aware of the investment through our own research into publicly listed companies that conform to our Industries of the Future criteria. In the case of Cafédirect, the issuance was managed by Triodos Bank, who approached us.”

“We were approached to invest in both the Ethical Property Company and Cafédirect. We receive approaches from unlisted social purpose businesses approximately every 6 months, so not very many. These are usually early stage equity investments, such as Key Homes.”

Investment decision

“We evaluate companies on the basis of whether or not they fit within our Industries of the Future framework, which makes up an important part of the Fund. This is based on 10 themes such as clean energy, education, health care. We determine whether the company fits with our investment objectives on this basis of this and its financial fundamentals.”

“We perceived the EPC to be a good investment, but there were issues relating to its listing on the EtheX matched exchange market. These relate to the fact that the company effectively sets its own share price. This is understandable because it takes out the element of speculation in the share price of the company. However, this system could be very open to abuse. In the case of EPC, it was easier for us to accept because the share price is set in relation to NAV which is based on an audited figure, which reduces risk. In the case of Cafédirect, we were not comfortable with the investment because again the share price was set by the company. In this case there were no tangible assets on which to base the share price. It was determined as a multiple of the profits after marketing cost.”

Valuing the social mission

“We determine value through the mechanism of share price, which is set by the market (demand vs. supply). What is difficult is to determine the means of price discovery: How do you get around the issues of setting share price?”

“We assess a company purely on the basis of the financial fundamentals and value. We can however determine that social or environmental value will create financial value over time. Very few fund managers are able to forgo financial return for a social benefit. No one has invested money with us for charitable reasons, and we have no mandate to forgo financial value in order to capture some unquantifiable social return. Social value may have added value in financial terms, and this is the lens through which we examine as investment.”

Investment performance

“While the investment in EPC has not lost value in a declining market, it has also not outperformed other property stocks. In a period in which the property sector was booming, the EPC remained relatively flat. So, had more of the fund been allocated to this equity, it would have performed relatively poorly. That said, it is a relatively small investment for the fund relative to its other holdings, and therefore has not had a material impact.”

Effect of listing

“There is more onus on the business when listing on an exchange, due to the disclosure and reporting requirements. In addition, there is an added level advisory and communications expertise required to communicate effectively to a wider range of shareholders. In shifting from a private to a public company, there are a broader group of shareholders that require accessible and credible information on a regular basis, which increases the level of disclosure, corporate governance, advisors etc required. The company must provide information to investors on a regular and consistent basis.”

Social capital market

“A market requires matching in a transparent and open manner. If this does not exist, there will not be sufficient liquidity to make it work, particularly not for public funds. Therefore a SCM would have to take the form of something akin to PLUS Markets, with stringent listing rules that include a social or ethical perspective. These guidelines would have to make investors comfortable that any company bought on the exchange was run in accordance with the designated values.”

“However, such a market runs the risk of potentially being closed off to those who are not socially motivated. The broader based of investors in the market is not investing on a social basis. It is also difficult for investors to get involved with a purely ethical company on that basis alone, because this loses sight of the investment fundamentals – and leads to getting involved for non-investment reasons.”

"I would question whether a company in listing on the social capital market would find it difficult to raise sufficient funds because of a more limited pool. There is a limited pool of capital available with a social or environmental purpose. In addition there are added costs to a dual listing: What would justify this for the company?"

"Why not just set up a social purpose index, which would include companies from either PLUS Markets, AIM, or All-share, and would achieve the same purpose but conform to specific criteria set by managers. One could then create investment products on the basis of this index without the extra cost associated with listing."

"If the social capital market is focussed on social return, rather than financial return, then liquidity will be low. It would not be something that public funds could get involved in, and would have to be focussed on HNWI and foundations. This would involve an entirely different order of magnitude in terms of size."

*These opinions are expressed by George Latham in an individual capacity and do not represent the view of Henderson Global Investors.

Gary Laing*

Broker

AXA Investment Management

AXA Ethical Fund has EUR 700 million under management as at 30 June 2005

Investment Objective

"We only do one ethical fund, which is called AXA Ethical Fund. We use EIRIS to do all of our screening. It is purely negative screening. It could be classed as very dark green, as it uses EIRIS' most negative screen. We've got no committee ourselves, everything is decided by EIRIS."

"Our French counterparts have about 18 ethical funds, but their thoughts on ethical and ours are completely different. They do not have a problem with animal testing and stuff like that. We are far more stringent here in the UK."

Minimum Market Cap Size

"The Fund doesn't have a minimum market cap but it is primarily looking at the larger cap companies of mainly £350 million. It is a pure growth fund with a slight dividend."

Investment channels

"We are not really known as a UK house for ethical investing, so not to my knowledge, has any ethical business approached us."

Investment decision

"You would value it the same way as any other business, they just put the ethical criteria on it."

Valuing the social mission

"I think it will take a while to value social mission, to be honest. Because the City at the moment is still: profits, profits, profits and performance, performance, performance. But I think as demand grows for ethical products, the City will change. ...It is a growing market. But that is what clients want, and it is a growing market. If they want ethical they are going to have to take a bit of a hit in the performance."

Investment performance

"No, we are not satisfied with performance but to be honest there is not a lot that can be done about that. We can't invest in oil, and Vodafone has been in and out. So, no the performance has not been good. Because of the screening there is not a lot that can be done about it. That is part of the reason we have looked at changing it and making the fund slightly less dark green."

"If you invest in ethical you have got to know that you are going to get less of a return. That would be a big issue. They are more patient investors. Thinking about ethical investments, the fund does not perform very well, but we haven't really lost a huge amount."

Effect of listing

"If you think of Vesta Wind Systems, it has been fantastic, it has done great for this business. ...It's good for both its operations and its valuation. If the company certainly has a robust business model and it is ethical, I do not think listing poses a problem whatsoever. It can go up in value. If it is going to be small cap you might have a problem with really big funds taking a positions in it, but I think it would do the company good, and it would look favourably upon someone with an ethical criteria."

Social capital market

"I would worry that there would be enough stocks to choose from, and the liquidity issue would be huge, I would think. Thinking about the VCT market, they all invest in about 25 per cent of the market, and that is pure liquidity, and I would suggest that this market would be the same."

"If you look at some of these AIM stocks, and their market cap is minute. If you can get the stocks, if you had an index on AIM, if you consider the number of ethical funds out there, if they all start piling into these companies, could they produce the stock without liquidising it right down? I don't know."

"I think there would have to be a body that would check that the company is doing what they say they are doing, something like EIRIS. It would have to be a bit more stringent, which would add a cost, I would think. I would think there would be a cost for the company, which would take away from their profitability."

"I think it is a really good idea, but whether it is going to work in reality I don't know. It is going to up the risk of everybody's fund. Are you going to be able to get in and out? What kind of trading volumes are you going to get, and liquidity would be my issues, but I think it is a good idea. I will watch it with interest to see if it works."

*These opinions are expressed by Gary Laing in an individual capacity and do not represent the view of AXA Investment Managers.

Michael Fox

SRI Fund Manager

Co-operative Financial Services

CIS Sustainable Leaders Trust has £102 million under management as at 28 April 2005

Investment Objective

"There are basically three strands to it. We have negative screens which currently consist of armaments, tobacco, animal testing for the purposes of cosmetics, and nuclear power. The second strand is that it has positive criteria which are benefitting the environment, human health, safety or what we call quality of life.... It has a final strand, which is to invest in companies who are leaders in corporate social responsibility."

Minimum Market Cap Size

"there is no minimum market cap. The smallest company that we invest in is about £50 million in size, although we could invest in smaller market caps due to the fund being a decent size. But given issues of liquidity we would very rarely go below £50 million, but there are no actual restrictions."

Investment channels

"We have a process that effectively screens all of the FTSE 350 for any companies that may be suitable and that selectively goes down into smaller and listed companies. ... We do get propositions from companies that have a very strong environmental angle, but that are very difficult to value or have firm understanding of their objectives."

"We are very proactive in our approach and it is in our interest to be aware of companies who have a particular social, environmental or ethical angle to them. ... In reality we should be finding them, not them finding us. We do tend to find most of those we are interested in. The companies we invest in are perhaps a little bit more mainstream than some of the AIM listed companies."

"The companies we are approached with are predominantly the ones with a strong environmental angle. They tend to be new energy technologies and very small companies that may be looking to raise cash for the first time. We typically don't get involved with companies like that because of the risk profile."

Investment decision

"The point I would make to you is that the financial criteria that we have are equally as important as the non-financial ones. ... What seems to be suitable for institutions like ours are not suitable because of the difficulty of valuing the company and understanding the drivers of the business. For example, a classic a few years ago would be something like solar power, which obviously has got a very strong ethical angle, environmental angle to it. But the companies are almost impossible to value and subsequently turned out to be very poor investments, so we have to marry the two really: the financial and the non-financial for a company to be suitable for investment by the trust."

Valuing the social mission

"I don't treat them any different from other companies in terms of how I would value them. A business is worth its future cash flows discounted by an appropriate rate whether it be a social company or not. The theory is the same regardless of its social responsibility. Personally I value them in exactly the same way, and I would be surprised if others didn't."

"If a company is particularly aligned with some macro drivers, whether they be environmental legislation, health care, or ageing population, there is a tangible benefit to that and we would build that into our financial model in terms of greater sales prospects,

maybe better margins. They are built in, but in a traditional way in terms of sales and margins. There is no extra line in the valuation that adds value on for being socially responsible.”

“I could see why some people argue that socially responsible companies should be better investments, and we agree with that. But it is going to be quantifiable and it has got to be something that can be put into the valuation with a reasonable degree of certainty and that tends to come down to businesses that have better sales prospects.”

Investment performance

“I think this trust, in common with a large number of trusts, invested in a large number of wind and solar power technologies ..., which coincided with the technology boom of the late 90s. We learnt some pretty good lessons there in that you have got to make sure that whatever you invest in has a good financial return as well.”

“The kind of companies that act in a socially responsible manner or companies that play on healthcare, which ties into an ageing population, or health and safety, they have been more fruitful in terms of providing investment returns.”

Effect of listing

“Every business has got to make a profit, it’s got to pay its employees. Charities can be expected to be charities, businesses can’t be expected to be charities. Nor can investors such as us expect to be charitable organisations handing out money to businesses that ultimately may not produce a profit. I don’t think it affects the businesses in the sense that any business has got to make money, and being listed only brings that home to you more.”

Social capital market

“When you start creating a benchmark of socially responsible companies, then who can determine what is a socially responsible company and what isn’t?... Now nobody is right and nobody’s is wrong it just reflects that we all have different approaches.”

“I think there would have to be some agreed and stable criteria to it as to what is and what isn’t a social company, and therefore what should be in it. I think it would be very difficult to do that because I think people have differing views.”

“I think it would have to have a strong identity as to what it stood for. ...It would have to be a very specific, firm criteria in terms of what it was trying to do, and stick to that.”

“Personally I think the UK stock market does a pretty good job of allowing companies to raise capital in terms of good companies and good ideas find capital reasonably easy. Companies may say something different to that, but I think the market works quite efficiently in that way. I don’t personally see that an extra index for these companies would facilitate that.”

“At the moment, we are not seeing huge demand for socially responsible investment products as such. There is no reason why that can’t change. Having a more public index could be a way of changing people’s perceptions of what the ethical investment industry does.”

“I would hope the social purpose businesses would be stocks that we would have considered buying regardless of whether they’re on the exchange or not. The fact that they’re on there wouldn’t make us more likely to buy them. They would have to meet financial criteria as well.”

Alex Illingworth

Director

Global Equity Funds

Insight Investment Management Limited

Insight Evergreen and Insight European Ethical have respectively £34.3 million and £70.8 million under management as at 28 February 2006

Investment Objective

“The main criteria are similar and based around what you might expect from an environmental/ethical fund – human rights, nuclear power, etc. Where they differ is that there is a meat screen in the Evergreen fund, and ...alcoholic beverages are totally excluded in the Evergreen Fund, but not totally excluded in the European Ethical Fund. The other major difference is on animal testing, Evergreen talks about not investing in companies where the company has tested on animals for either human or cosmetics purposes, whereas the European ethical makes a distinction between those two.”

“There is more positive screening on the European Ethical, but essentially they are both governed by number of negative screens. The Evergreen Fund goes on to talk about how the portfolio should be biased towards those companies that are doing good in the world or are environmentally friendly, alternative energy focussed.”

Minimum Market Cap Size

"We do not have a minimum market cap, per se, no. We think the most important thing is that the liquidity is there in order to allow us to get out at a reasonable timeframe.... We are not allowed to invest in anything that is not listed, as yet."

"Ideally what I have got to make sure if I am investing that far down the market cap curve that you have absolutely got clarification that the path to profitability is there, that you are going to make a lot of money in the long run....If you invest lower down the market cap scale, then you will be increasing that risk, and I don't want that risk to blow out because I think the right product to give consumers is one that consistently outperforms."

Investment channels

"By virtue of having these funds, there are plenty of companies that come through the door looking for funding. I have the funds... We would have the inclination to support these stocks, but at the end of the day I have got to make sure that they have got the path to profitability and I think I am going to make money. Unfortunately these funds are not here to subsidise the growth of socially beneficial companies, they are here to make money for the investors."

Investment decision

"The difficulty for an investment manager is that there are plenty of ideas and you want to get the very best one. Perfectly decent companies that do not go very far are not of great interest, especially if they are very small, to the investment community. Unless it is a small company with very explosive growth."

"What I am looking for is to invest in the right stocks in order to deliver the return, and it is important to focus on both types of areas, because that is what the fund is about, but at the end of the day you have got to find moneymaking ideas. So it is a very subjective area. It is like the definition of ethical: what is the definition of ethical? Everybody has a different idea of what is ethical."

"The role of the fund manager is to look at the financials. To look at the product and see what they can deliver. If it does good for the world then so much the better, but you have got to make sure you are making the right financial decision."

Valuing the social mission

"There are many businesses that have social or environmental objectives, but of course as you know, those objectives vary

widely. It is certainly the job of the corporate governance and the engagement team to determine whether those policies actually are meaningful and whether they are enacting change within the company, or whether they are just ticking the box.”

“My job, being the guardian of the money that the fund holders have put into these funds, is to maximise returns and not specifically look at the socially beneficial nature. At the end of the day the decision has to be financial. Of course it is a growth area. People are keen to embrace these ideas, and that can be quite a strong selling point. With Cafédirect people want to buy fair trade coffee, and that can work in the favour in the financials. But I have to say, it is harsh, but it has to be whether the numbers work.”

Investment performance

“I think they are volatile, some of the companies are small, some of them you get wrong. ...But in general, certainly over the past three years, the performance has been borne out by the fact that we have been able to deliver good return, and a lot of those returns have come from these particular areas. I think all these points can work to embrace a virtuous circle, for stocks to do well, funds to make money, and the world can be a better place.”

“What they will lose is investor attention if they do not deliver the financial results.”

Effect of listing

“There is no doubt that great financial strains are placed on companies that become public. They do become public with a product idea, with no revenue and no profits. They need to deliver, and that can cause strain, I am sure, because it may not be what the original founders were focussed on trying to deliver.”

Social capital market

“You have got to make sure that there are good reasons for socially beneficial businesses to come to that exchange. What I mean by that is that they have to be able to get access to capital, that it would be better for them to go to that exchange than to go to the normal market. In order to do that I think you need strong support from a number of different bodies, both government and financial.”

“I think it is a nice idea, but companies that become public need to be able to grow. ...Just accessing the market for capital to save the world, is unfortunately not what financial markets are about.”

"You have also got to ask the question: If a company goes to that exchange and does not cut it through one of the normal exchanges: Why has it gone to that exchange? Is that it because has not got a business plan that will stand up to scrutiny of the investment management community? Is that why they have gone to that exchange?...If a company went to a socially beneficial index, investors might ask why it did not come to a more normal index."

"I think any index has got to have access to capital for the companies, it has got to have liquidity, and it has got to have a reason for investment managers to want to buy into that index.... The corporate governance quality of companies on AIM are much lower than some of the major companies. I suppose if this index or exchange was one which was very severe about its corporate governance to start, yet also cheap for the companies to list on, then you might have a differentiation."

David Richardson

Divisional Director
Investment Management
Rensburg Sheppards Investment Management

Investment Objective

"We do not run any in house ethical pooled vehicles at all for our charitable funds. We apply it in a bespoke way for each client."

"About 60 per cent of our funds tend to impose a restriction on things they find they do not want such as alcohol, tobacco, arms, that sort of thing."

"It is less usual to find the actively positively ethical. Probably 60 per cent of our charity clients impose some kind of ethical restriction in a more negative way, for example, medical criteria such as tobacco shares. Yes 2/3rds of our clients would have some form of prescription on there but very few actively tell us to go out and seek out environmentally friendly companies. It is becoming a common topic for discussion at trustee meetings."

Minimum Market Cap Size

"It is not a restriction, it is just that small cap stocks are probably not suitable because they are too speculative. The companies may be too young, they may be too small, it is difficult to meet the management and their businesses are less stable. A lot of our clients require steady dividend streams from companies in order to meet their spending obligations and you do not get those from companies with market caps of £100 million or less."

Investment channels

"Some of our clients have ethical policies in that they do not want to invest in companies that pollute, but not many have actually yet told us to go out and seek alternative energy companies to invest in. Although it has come up at one or two trustees meetings that I have been to, it is still quite unusual. But it is a growing phenomenon."

Investment decision

"Most of these charities, quite rightly, their main aim is to generate as much money as they can in order to carry out their charitable work. If they want to actually use the charity's funds to promote a political or social agenda, that has to be secondary. I am just not aware of many that have."

"UK law requires charitable foundations to pay primary concern to the investment needs of the charity."

Social capital market

"I think it is quite an interesting idea. I suspect as time passes, it will also grow. Our clients at the moment are becoming more interested, particularly now as the 2005 Statement of Recommended Practice requires UK charities to disclose their ethical policies."

"Charities have a legal and fiduciary obligation to do the best with their funds. Trustees have that obligation as established via the Bishop of Oxford legal case. I think it is probably something that will come, and that will become more of a factor in trustees' minds."

"It is not necessarily something we as fund managers think we should be trying to get our clients to do. We manage portfolios for the clients. We try to fit in with what the clients' want and respond to their needs. That is our business, rather than trying to steer the client into things."

"I do not think that people would be willing to invest in them unless they thought that they were going to get a reasonable return. I do not think that they can invest in them just on ethical grounds alone."

"It may be also that the charity might not decide to put all of its money in to such a fund, but to put 10 per cent or something. People may see it as a partial thing, possibly that is more likely."

"The other point that you might find with such a market, is that the market have an unusual composition of companies, and quite strong sector biases, because some industries are obviously more ethically inclined than others. ... So you might find that it might develop quite a biased index that was derived from such a market. It would tend to have a lot of service businesses, and probably not many manufacturing businesses. That might put some people off because you were getting such distorted sample."

"I personally approve of the idea of socially responsibly investing, but ultimately investment managers really, I feel, must do what their clients want rather than try and steer their clients. I mean they must advise their clients into which areas they think will do well, and which will do badly. But it is not up to me to go to my clients and say 'Look I think you should put 10 per cent of your money into this fund because it invests only in fair trade, and I think you ought to be investing in that for moral reasons.' A fund manager must not impose his ethical and moral constraints on the fund. That is what the trustees are there to do."

Suzie Kemp

Vice President

Credit Suisse Asset Management

Credit Suisse Fellowship Fund

CS Premiership Fund

Investment Objective

"I look after a growth fund which has no social or ethical criteria which has about £45 million. I also manage a social and ethical fund which is about £85 million and I look after an account for a large religious organisation which is about £250 million in UK equities and that has some limited, ethical, more than social objectives – they rule out armaments and investments in brewers and alcoholic beverages companies."

"We do not run any funds that are proactively investing in social businesses at the moment."

Minimum Market Cap Size

"We are a little bit flexible depending on the business, so obviously if it something that we think would offer good long term growth potential and fits with the ethical, social remit we will look at smaller. I would say generally the cut off point would be about £50 million. We do own AIM stocks, but we do not have any PLUS Markets at the moment."

Investment channels

"We have had more a lot of companies on an environmental tack that have approached us to invest. A lot of those have been quite early stage. ...Over the last few years we have seen a lot of small cap stocks that have been specifically aimed at ethical funds, but they have been far more in the environmental area rather than social. In actual fact there are very few social purpose businesses that I am aware of, and certainly we have not been approached by any."

Investment decision

"Generally they tend to be higher risk investment propositions than the mainstream stocks where you get good analyst coverage and you can see what the earnings progression of the company should be and you can take a view, ...it is just more to do with investors appetite for risk."

"Often we felt that the businesses were too high risk, and more of a sort of proposition rather than actual businesses. It was a bit blue sky with nothing tangible there really. Possibly the lack of assets, or lack of proven expertise, or just that it hasn't really suited."

"Generally these are the assets that people do not want to hold onto because they would rather be in something bigger and safer that pays dividends. So that even if you do not have capital growth you would be rewarded as a shareholder in some way. Generally you do not get that with these stocks."

Investment performance

"From my experience of what has happened to environmental businesses, they can trade for years without anyone really paying much interest to them, and then suddenly you can have a situation where you have a high oil price and alternative power becomes more economically viable and people see this as a great growth area going forward. These things can literally double, move 100 or 200 per cent in the space of a few months, from a position where the market has largely ignored them, and then suddenly the market completely re-evaluates the way it looks at these things."

Social capital market

"I suspect that in some ways it would make more sense if it was easier to have a social purpose vehicle than those stocks are not going to be benchmarked against stocks that are just basically trading to deliver profits to shareholders."

"A charity may stipulate that they want to put 10 per cent of their investment in social purpose vehicles and that kind of investment, whereas a few of the pension funds or British Telecom or the big companies are just interested in maximising returns really. It would very much come down to the profile of the investor at the end of the day."

"I suspect there could be liquidity problems, because the actual number of investors using the exchange could be quite small."

"Given that our fund is benchmarked against the All Share index, and that is the index that we are trying to at least match the returns of, it is quite difficult anyway, because we rule out about 30 per cent of that index on ethical grounds. I sense that whilst it is something that we consider, it is more likely to be an exchange that funds with certain guidelines, or client guidelines would use, rather than funds with more mainstream investments."

"I wonder whether you would need government legislation as well to give some sort of tax breaks or special treatment to investors who get involved in these companies, that would hopefully help to drive liquidity in the market, if you were being treated differently from a tax perspective than investing in mainstream stocks. That would be one way of attracting more mainstream investors' interest in this area."

Joel Moreland

Equity and Investment Manager
Triodos Bank

Triodos UK held EUR 280 million (£197 million) in deposits and EUR 128 million (£90 million) in loans outstanding as at 30 June 2004

Advisory Role

"We work only with organisations that are similar to the ones we would lend to, which are organic food, fair trade, renewable energy organisations looking to make a positive difference."

"We meet the organisation and talk to them about their governance and capital structure, and readiness for raising capital... Then we look with them to try and identify a constituency that would invest in them; a mixture of our own constituency and...their suppliers, customers and stakeholders, associated organisations. We consider how we can market ... because the biggest cost in raising capital always is the marketing."

...We work out the key messages of the campaign and how they are going to be communicated, and then build the prospectus and other marketing materials around that. ...That is the public offer side."

Balancing Financial & Social Objectives

"You could pull out a mean and a median, but they would not represent the breadth of investors. For some people the social return is irrelevant, and for other people it is everything. We just put up what the best financial return that is reasonable to present, and the best social return that is reasonable to present, and then people choose from that. We don't try to overemphasize one or underemphasize the other. We put it out so people can see it."

"We've been told, with pretty much everyone we worked with, ...that we've been chosen because of our understanding of both the financial side and also the ethical side of their business. We believe that where you share a motivation both to make money and make the world a better place, then that's how Triodos is. We are not charitable organisation, we are both financially and socially motivated."

Investment channel

"Organisations that Triodos could help would only be 1 or 2 listing a year for quite some years, at least 5 years. If you dilute the definition until you get to something like social purpose businesses – and I think that's potentially even a slightly generous term, because they haven't got a social purpose, they are profit maximising businesses that have some social impact – then there is many more that could list. It is just about your definition. We define those businesses as those making positive environmental or social difference, and that has to be in the motivation of the senior people involved."

Listing process

"Going to the main list is very expensive. There are the charges of dealing with the compliance and the due diligence, which can be very high. It is often not particularly cost effective, given that the tradability of the shares is often not very high, even when you get onto AIM or PLUS Markets."

"...Most of the AIM and PLUS Markets listings tend to be much more institutional shareholder base, which is not always what the organisations want. Often they want to engage with a wider group of stakeholders and to be owned by their stakeholders."

"We went after the fund managers that would understand the objective of the company. ... Our focus is on the ethical fund managers, because even with them they rarely invest in these public offers anyway, so there is not much point to going to anybody else."

"Listing is not a service that you can offer to many people because it costs so much to get the investors in. We have helped organisations get what we think is a good conversion rate. For people who get the prospectus, about a quarter of them invest. It's getting the people to enquire, and all the materials you have to produce, and the time and the effort, and handling all the applications. ...It is not something that can happen for many organisations, which is disappointing. One of the barriers is the cost of marketing. It's not the quality of the organisation that is the problem, it's the cost of marketing."

Valuing the social mission

"We find some people who just come in to the organisation, feel that it is a good organisation and we have organised a good tax break, which is enough for them. Whereas other investors, it's practically a donation. It is a huge spectrum."

"For Cafédirect, which is a business with no assets at all, we worked with the directors to use a multiple of earnings. For the Ethical Property Company, which is property focussed, there are a number of comparables out there, so you can build a valuation around that. It just depends on the business. I don't think we would really use discounted cash flows for a public offer. It needs to be concepts that are reasonably approachable for people."

"...You have got that group of investors...who are looking more for the social or environmental return, so they are less worried by the financial. I think a lot of the individual investors out there, their biggest concerns are a guaranteed return and a regular return. If you can guarantee my capital and give me a regular return, I'll be happy. And those are two things you can never promise to do with an investment. But that's a big interest for people."

Creating a social capital market

"There is a good degree of support for this idea. The key question is when will this happen, not if. And the fund managers will come."

"I think it will happen one day, but not for quite some time because there are not enough organisations would want to join."

...In terms of ethical businesses in Triodos' definition, not all of them want to be listed yet. In the social purpose definition of businesses, not all of them want to be tarred with being placed in a specific index."

"... I think organisations that are social purpose, where there is a bit of them that is a bit ethical, they will see themselves as a mainstream profit-maximising business that does business in a more responsible way. And they benefit from doing that. They are not freaky sideline people, they want to be mainstream."

"You want the exchange to be as similar to the mainstream market as possible. It is just AIM, but a bit different. Because then investors are more comfortable with it. I think the real difference is around accessibility for the general public to be invested, because they are more likely to be in these than they are the other AIM stocks."

"It is about protection of the businesses so that they can't be taken over. This will mean that they will trade at a discount to their mainstream peers, but this would be the way to attract the really ethical businesses, because they want their fundamental reason for being to be protected. But in the process of doing that, you will actually get less of the mainstream companies coming in, because they will know that they will then trade at a discount."

"...If you imagine two very similar companies, one with the social bit, and one on the main exchange, there'll be something like a 20 per cent discount because of control. That's fine, but it will mean that you won't attract a lot of the mainstream companies to come on, because a lot of the directors will be rewarded by options based on the share price, and they won't want to factor in an instant 20 per cent discount to their remuneration."

"...There will be more institutional investor interest because there will be price discovery and there will be market makers. The actual liquidity will probably not be massively better, particularly if you get institutional investors involved because they buy big chunks, and when they trade them, they trade big chunks, so the day to day liquidity doesn't change much. Liquidity means two different things. There is liquidity at any price, which is what a made market gives you, and then there is liquidity at a reasonable price."

Malcolm Lynch

Partner

Charities and Social Economy Department

Wrigleys Solicitors

Advisory Role

"We have been working with charities and other social enterprise, social economy organisations for about 25 years on a broad range of matters, including financial services matters."

"We act for a range of clients, including people like Cafédirect who issue shares, so that kind of social enterprise business, wind farms who issue shares, and some charities which issue shares, some of the social services charities."

Balancing Financial & Social Objectives

"Organisations come to us because they know we have expertise in raising money from the public, particularly for organisations which have got social goals as well as economic goals."

Investment channel

"We probably advise on average 1 or 2 a year over that 25 year period on raising money in various kinds of ways, including from the public. None of my clients have been listed, but a large number have raised money from the public."

Listing process

"Some of the larger issues have contacted institutional funds, like Ethical Property Company and Cafédirect, but there are limitations to what those funds can invest in because of the nature of their structure, and they will not be suitable for a lot of social enterprise or socially responsible businesses at a particular stage of development."

"What the social purpose business might be compromised by is the market's expectation of rights attached to share capital, and whether there should be limitations on rights attached to share capital. The market expects that there is no distinction between types of ordinary shares, and there is no limitation on numbers of shares that can be held by particular people, and if you start to introduce restrictions in that respect to keep the organisation socially responsible, and prevent takeover by a socially irresponsible organisation, then technically the market is not going to be particularly in favour of it and potentially neither are the SRI funds."

Valuing the social mission

"I think investors are making a measurement on both social and economic basis. For some investors the economic is more important, for others the social is more important, and they make a self assessment based on the information the company provides to them."

Creating a social capital market

"I think there is a merit in it, but the economics of it don't add up at the moment. In terms of the administration of a market of that sort, it's not a particularly profit making venture. Therefore it is difficult to create a market of that sort without it having a critical mass. But we haven't got a critical mass of businesses at the moment."

"To what extent, how can the exchange build investor appetite for this, because that requires marketing expenditure."

"What is important is the ability of the exchange to deliver appropriate services; like adequate registrar services, publicity, member and shareholder contact."

"I think that what investors are looking for is liquidity really – the opportunity to buy and to sell. It is creating that liquidity which is the difficult thing. That is important for the long term success of the companies making that share issue as well as any market itself."

"I'd expect the exchange to deliver matching service for buyers and sellers, I'd expect it to deliver publicity which would help fuel investors interest in a market in the shares of those companies, and also deliver access to material about those companies."

"What is more interesting is perhaps looking at building up the actual investor networks which might provide individuals across the UK who are interested in investing in these kind of enterprises, but perhaps might be interested in making those investments in an earlier stage before it goes public, in much earlier stages of financing. ... By the nature of having these kinds of investor networks, investors would be interested in being invested in these kinds of companies subsequently."

Mark Evans

Head of Family Business
Coutts & Co

Advise family business owners and philanthropists on creating effective giving strategies

Balancing Financial & Social Objectives

"A lot of private clients are keen to understand more about what is going on in this sector, but they have not decided whether they are going to commit any funds. It is clearly a combination of wanting to get a good financial return and create some social benefit as well, but I am not sure...the ones I have talked to, have thought through what the right balance between those two is and whether they are ready, for example, to take a discount to the sort of financial return you could get if you didn't apply a social model."

Investment channel

"A few businesses that would be small to medium sized social enterprises have approached us with a view to introducing them to private clients who would want to take private equity."

"We became aware of investment opportunities mainly through the charity network, but also through private clients who have invested in opportunities like that, perhaps have invested in the first round, and then have approached us and asked if there were any other clients who might be interested in a similar opportunity."

"My sense is that social purpose investments would be perceived as slightly high risk, just because you have limited the number of opportunities or options that an investor potentially has, and on that basis might miss out on some of the upswings in the market."

Valuing the social mission

"Investors don't tend to value the business, they tend to just look at the opportunity. I think it's more intuitive at this stage, if they like what the business is all about, and they like the sector it sits in, then they will take it a stage further."

"I think the general perception is that ethical funds are underperforming the market. Rightly or wrongly that is what the perception is. I think that if you tie one hand behind somebody's back, and ask them to screen out this or screen in that, which you wouldn't normally have done, then you are limiting his or her ability to produce the optimal return."

"It may be that what investors have to do is think in terms of setting up a separate portfolio that is measured against a separate benchmark, rather than including ethical funds in their overall portfolio which might bring the weighting down."

Creating a social capital market

"I think there is general interest from the charity clients that we manage in social funds, and there is growing interest from private clients in understanding what social funds are all about."

"I think it is an interesting idea, I just wonder if it is too early days. I still think that there is a lot of education to be done in this market. We run a series of philanthropy events for clients to help them understand more about what is going on in the market in general, and it touches on SRI, but you get a sense that people still don't know enough about the basics... We need to bring more people up the curve and have a much higher level of interest in the whole market before doing anything like creating a social exchange."

"It is still a very small pool of people that is beginning to get interested in this space. It's not to say that there isn't a much bigger market for it, I am sure there is, but it's got a way to go."

"Ultimately, if it is going to work, it would need to provide some sort of mechanism for people to evaluate the performance of the underlying funds. There needs to be different levels: one level is that it needs to be informative, to give information about what the funds are, and then a second part to tell people how the sector is doing how the funds are doing, and keep them in touch on a regular basis on what is going on."

Mark Taylor

Charles Stanley & Co

Advisory Role

"Charles Stanley is a small cap corporate finance and broking. We specifically advise small and mid cap companies in the range of anything from £0 to £250 million market cap, but our usual range is the sub £100 million market cap companies. Our typical client is somewhere in the region of £10 to £60 million market cap. We are primarily corporate finance and corporate broking, we are primarily advising listed companies. We don't specialise in the area of social and ethical companies, but rather focus on smaller and growing companies."

Balancing Financial & Social Objectives

"As long as the social objective of the company is boxed off, and discussed openly, and operating within the commercial, operational and financial parameters, it is not an issue. But if we talk about a change where the sole focus of the company becomes to manufacture and distribute products on a charitable basis, then existing shareholders are going to be potentially of a different view."

Investment channel

"There are a range of funds looking to make investments in this area. The issue as I see it is one of size. Socially responsible funds have minimum market cap size criteria, and that is going to make it difficult. ...A lot of ... generalist funds are looking for slightly larger companies typically. But I think there is a reasonable amount of companies that fit the criteria that are sub £100 million looking to come to market or looking to raise capital."

"Institutional funds are investing for a reason in profitable and growing businesses. ... Their fundamental decision to invest or not invest, is based on the prospects of the company. And that is what is emphasized in the issuing process."

"I often think that with ethical funds you have to do quite a lot of work to find them. They are not coming to you. Whereas if I have an ethical company that may be suitable for ethical investors I have to do quite a lot of work to find out who they are rather than knowing who they are from the point of view of visibility."

"The larger funds who do have social funds as part of their mandates invest in much larger companies than a £10 million business or even a £50 million business. In general, ironically they may end up investing in less ethical business as a result."

Listing process

"The social aspect of the business was discussed, ...as another marketing angle for the company to increase and widen the number of potential investors they could go and talk to. Did we find a lot of response from the social funds? No, not really."

"When we have small companies that we are going to IPO that do have an ethical or green element to them ...quite often it is chicken and egg – there needs to be a business there with contracts, making money, or delivering a service or products before these investors are prepared to put money into them."

"The company has a social element to it, but at the same time it was very much marketed, and the directors marketed it themselves, as a commercial business. That would be the case for the majority of companies that we deal with. Private companies that are considering coming to market with a real social, ethical or green element to them ...are coming to market very much because they believe they have a commercial product."

Valuing the social mission

"There is a risk, and that comes down to the financial performance of the business, the growth of the business. ...Shareholders are aware and are considerate of the social aspects of the business, but at the same time, I guess that if that was at the expense of profitability and general business dynamics of cash flow, cash flow management, profitability and survival, then they are not going to be that happy."

"There is the macro of : What are the valuation parameters, but there is the micro – the fact that I am a social purpose business, doing good: Does that have a value? How do you value? It is very difficult to put a metric on it, and markets ultimately care about valuation."

Creating a social capital market

"There are a lot of companies that I come across, smaller companies, that do have an ethical angle. They may be public or thinking of raising money. There is a requirement for that capital. But as a separate class of investment...I think it is quite difficult clearly because it comes down to the business parameters: having to make money, having to grow in order to be seen as a suitable listed company. Although there are funds, and there are an increasing number of funds, with a significant part of their mandate to invest in ethical or social businesses. But to create a market -- I would be surprised if we saw it in the near future."

"The value of a business is ultimately going to come down to cash generation and profitability. That is the dilemma that I see in terms of this market."

"It is chicken and egg – there needs to be a business with contracts, making money, or delivering a service or products before these investors are prepared to put money into them."

Jed Emerson

Senior Fellow

Generation Foundation

Generation Investment Management

Balancing Financial & Social Objectives

"We have created all of these systems based on the idea that you can bifurcate value, that you can separate economic, social and environmental considerations. There is the notion that simply because you treat something as an externality and don't integrate it into your balance sheet or numeric analysis, it goes away.... But the reality is that simply because you don't see something doesn't mean it doesn't exist."

"I think people have done a pretty poor job to date of enunciating what is this social and environmental value component of the businesses that they are involved in developing. If there is one thing that capital does not like, it is lack of definition and clarity."

"The reason most entrepreneurs create companies is for more than just money. They obviously want to create something that has economic and financial value, but often the most successful entrepreneurs are usually more interested in innovation or creating value for the end user. And this often translates into things that go well beyond financial or economic impact."

Investment channel

"A critical question becomes: 'How do you deal with a highly fragmented and pre-developed space where angel investors and capitalists are not connected well and there is not a smooth transition from one level of capital to the next?'"

Valuing the social mission

"What will happen over time is two things: an increasing number of companies will come to market with much more explicitly enunciated social and environmental value components to their business model, and I think we will see more and more traditional, mainstream companies, try to reinvent some of what they are doing in order to respond to the emerging reality of what it means to create full value."

Creating a social capital market

"...In terms of creating common terminology and metrics...you do not see everybody using the same frameworks and approach, and until we do capital will be limited or will not come forward. Those are the two key fundamental challenges that would have to be addressed before we move to ... the creation of a public market space."

“People respond to incentives. So at one level the first incentive to achieve the necessary shift is: We need to have asset owners (not money managers, but rather the people who actually own the capital) begin to say to their asset managers: “I want to see a strategy that reflects this blended value concept of what it is that we are investing in.”

“The tax and regulatory playing field is structured on a retrospective basis; it is structured based upon what we have seen versus what we would like to see or a vision of what should be. Therefore, it tends to be based largely upon an old, industrial capitalism approach, it is not based on a sustainable capitalism approach. ...Even if you had some number of investors willing to put capital in, or money managers willing to find the right companies, the companies themselves are not able to capture their full potential value because of a tax policy and regulatory structure that is looking to the past and not the future needs of companies, investors and the larger stakeholder community.”

“Capital providers: pension funds, endowments, foundations, and other actors in the capital markets need to begin holding their money managers accountable for performance that is more than simple, short term financial performance if they are to ensure the long-term value of their funds and the attainment of their overall institutional mission.”

“Among other factors, any viable capital market has got to have transparency, common terminology, and third party validation.”



Rodney Schwartz

Founder and Chief Executive

Catalyst Fund Management & Research Ltd

The European Financial Services Venture Fund (EFSVF) is a £40 million fund focused on backing revolutionaries with radical business models. Catalyst, in partnership with The Big Issue, is seeking to raise a social sector investment fund focussed on education, health, the environment and community development.

Balancing Financial & Social Objectives

“Once you’re publicly listed, you’ve lost the social angle. The market is designed to allocate capital not deal with social criteria. That is a bargain you make when you list.”

“The only hope for social businesses, wishing to completely stick to their social agenda, is to raise capital from investors who are investing for more than purely financial reasons.”

"As of today there are not many investors like this—this seriously limits the pool of capital to social enterprises, confronting them with a choice of 'selling out' or lacking sufficient access to capital."

Investment channel

"I think social business angels are one excellent source of capital for socially driven businesses. In addition to their financial resources, they often bring a valuable set of useful skills and experiences."

Valuing the social mission

"You sometimes get to a size when your initial investors cease to have the ability to continue to fund your business. There are institutional investors, with abundant capital resources, but they are inherently sceptical about social missions."

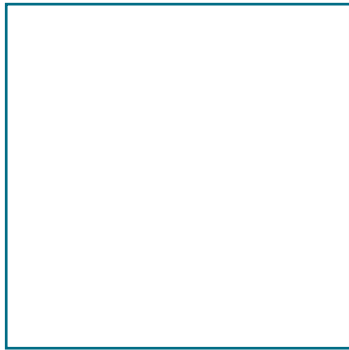
Creating a social capital market

"By the time someone needs serious money, the business model has to be so proven. At this stage such a business might be well-positioned to raise funds from private equity sources or the public markets, such as AIM."

"I hope it will happen (the rapid growth of social businesses), but I don't see it happening in the very short term. Unfortunately, the development of large numbers of successful social businesses is not hampered by a lack of capital, but by the absence of entrepreneurial models that make sense. This is unfortunate because good business practice is not really at odds with social objectives. In fact, I believe social entrepreneurs are sailing with the wind"

"I do not see a social market that is a mirror image of the conventional stock market but with social standards embedded. The obstacles are very great. However, something that looks like an information clearing house for investors, which might convey a 'Good Housekeeping' seal of approval, could be effective."

"Were the Government to assist with fiscal incentives this would obviously help. Perhaps they could eliminate the stamp duty in trading in such shares? I am not calling for this; however, as such subsidies tend to be highly distortive over time."

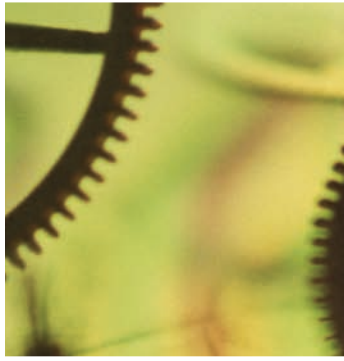


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