

Finance and funding for social enterprise

All businesses need finance or funding at some stage in their lives; to start up, to continue in business or to grow. A social enterprise, like any other business, will seek to become financially independent but many will require start-up and continuing support funding. You may be able to access some forms of funding or finance and not others dependent upon factors including your structure, governing documents and access to security.

This sheet gives a brief description of different forms of finance and funding and some of the advantages and disadvantages for each.

Deciding on your funding needs

First you must consider the following:

- Why do you need finance? For example, do you want to buy a property, invest in a new income generating activity or overcome a cashflow problem?
- How much do you want? This may help you see where the funding may come from.
- Are there different ways of being able to secure what you need? For example you could lease equipment rather than buying it to spread costs or you could secure a cheaper premises until you have started to generate sufficient income.
- When do you want it? You may want to phase your development or activities so that you do not overstretch yourselves financially.

- Do your structure, your objects or clauses in your governing documents enable or restrict your access to certain funding or finance?

Funding options

Overdraft

If you require access to a relatively small amount of money to, for example, cover a short term negative cashflow then an overdraft may be the most suitable option. Social enterprises may find it difficult to secure an overdraft facility from some banks. The Unity Trust Bank, as an example, provides an overdraft for those waiting for retrospective grant funding.

Grants

Many social enterprises seek start up and or some ongoing funding from grants, in particular where customers are unable to pay a commercial rate for goods or services. Social enterprises, depending upon their structure, charitable status and governing documents may be eligible for some forms of grant funding. Grants are attractive and can allow the enterprise to invest in resources to enable them to grow but they do have disadvantages that should be thought through carefully.

Some advantages and disadvantages of grant funding

Advantages

- Grants do not need to be repaid
- Grants can help to cover costs until income is generated

- Grants can be used to purchase assets that will allow the generation of income
- Grants can cover the costs of less viable but key parts of the enterprise's activity

Disadvantages

- Grants are short term
- Grants are often paid in arrears
- Grants are often restricted, are often for innovative project work and rarely cover core costs so they can distract from the main business
- Applying for funding and monitoring outputs when it is received is time consuming
- Grants are often inflexible
- An organisation can become grant reliant and when that funding goes the organisation is vulnerable

Some considerations when applying for grant funding

These may sound obvious but they are good reminders:

- Make sure that you have a constituted organisation, a good business plan and case for the funding
- Find funds whose criteria you can meet most fully
- Think through the requirements of the funding. Will you be able to manage the outputs whilst fulfilling your other activities
- Provide all information requested, ensure that the application addresses the criteria and submit on time!

Public sector contracts

Some statutory agencies are moving away from grant funding towards contracted services. Many social enterprises have contracts with public sector organisations and there are wide ranging opportunities for social enterprises to excel in this area. Social enterprises can also sell goods to the public sector. Contact ESN for advice on this area.

Factoring

If you have a problem getting otherwise good customers to pay on time then you could consider factoring. This is where you sell an asset (an invoice or other debt) to a factor who pays most of the amount up front and then the rest, minus a discount, when the invoice is settled. This is useful for small enterprises dealing with large, 'sound customers' such as local authorities or 'blue-chip' companies.

Discounting

It may be beneficial to implement incentives for customers to pay promptly. Such incentives could include a small discount for prompt or early payment or access to special offers for prompt payment.

Loans

If a financial investment will allow you to increase income in the future then loan finance will often be an ideal solution to your funding needs. Some social enterprises are precluded from taking out loans by their governing documents (although this can usually be changed) and some loan providers may require you to have security that you may not have, although many social lenders do not necessarily require securities. A working capital loan may be appropriate where you can draw down money up to an agreed amount. Loans may be available from mainstream banks, Community Development Finance Initiatives (CDFIs) such as Co-operative & Community Finance and social

banks such as the Charity Bank, Triodos and Unity Trust Bank.

The advantages and disadvantages of loan finance:

Advantages

- Loans are flexible and are not tied to outputs
- Loans are often quick to obtain
- Loan decisions are not competitive as grants funding is
- Loans help ensure that the enterprise concentrates on good financial management
- You can use a loan for bridging finance, e.g. before a grant is received

Disadvantages

- Lenders often want security over assets that could be lost if things go wrong
- It can be difficult to secure loans with no security
- Loans have to be repaid along with interest
- Start up loan funding is often hard to obtain

Loan Stock or Debenture

Loans can be “securitised” i.e. turned into a financial instrument having a sale price, redemption price, rate of interest, redemption date etc. This can be a useful way of raising finance from supporters of your organisation. For example a new building extension could be financed by a loan stock issue with a term of five years. This would give you five years use of the improvement before full repayment is due. Small local loan stock issues can be quite simple to accomplish.

Equity finance

Equity finance may be available to some social enterprises, dependent upon their structure. Equity is where the business cedes part ownership of the enterprise in return for a permanent capital investment.

Conventionally investors are looking for a return on their investment through dividend payments or the sale of shares. Investors in social enterprises will often have a social motive and they may accept preferential shares where dividend rates are capped. Equity stakes for employees may lead to improved business performance.

IPS share capital

Investors can currently invest up to £20,000. However many shares are held, the investor has one vote. This is particularly suited to enterprises where a large number of members or supporters may want to invest a small amount.

The advantages and disadvantages of equity finance:

Advantages

- Large sums can be obtained to allow for significant developments or asset purchase
- Security is not required
- There is no contractual agreement to repay
- Investors may provide support to the enterprise

Disadvantages

- Sharing ownership with investors who have financial rather than social aims can cause conflict
- Some legal structures do not allow access to equity finance
- Investors may be difficult to find with no or low potential return

Venture capital

There is little venture capital in the social enterprise sector but this may change.

Patient capital

Patient capital has traditionally been long repayment term equity-type investment in the private sector but is now being reinterpreted in the social economy as finance that is a stage between a grant and a loan. Providers include the Adventure Capital Fund www.adventurecapitalfund.org.uk

Mezzanine finance

Mezzanine finance can be structured as a loan but if the enterprise does very well then the financier may share in that success or if it does badly then the loan may convert into a grant. A provider is Venturesome www.cafonline.org



Legal structures and access to funding and finance	Can gain grants	Can borrow	Can issue loan stock or debenture	Can raise equity finance
Company limited by guarantee (CLG)	✓	✓	✓	x
Company limited by shares Private (CLS)	x	✓	✓	✓
Company limited by shares Public (PLC)	x	✓	✓	✓
Industrial and Provident Society (IPS) – BenCom	✓	✓	✓	✓
Industrial and Provident Society (IPS) Co-operative	x	✓	✓	✓
Community Interest Company	✓	✓	✓	✓ (if CLS)

Further help

Unlocking the Potential A guide to finance for social enterprise from the Social Enterprise Coalition

www.socialenterprise.org.uk

Local Investment Fund

www.lif.org.uk

Co-operative & Community Finance

www.icof.co.uk

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February 2009*



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