

■ Social Lending

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ASB Community Trust
Te Kaitiaki Putea o Tamaki o Tai Tokerau

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A new funding paradigm

Prospects for social lending and investment by foundations in New Zealand

This report was commissioned by the ASB Community Trust and The Tindall Foundation. It was produced by Glen Saunders in October 2009.

The two foundations wanted to find out:

- What are trusts and foundations doing overseas in social lending and investment?
- What is happening in New Zealand?
- What are the prospects for increasing this in New Zealand?

The questions are addressed in a public report which will be circulated widely. A number of trusts and foundations are interested in developing this activity and it is hoped that what is presented will be useful to them in taking this forward.

WHAT ARE SOCIAL ENTERPRISES

Social enterprises have appeared over the last forty years as a new and distinctive type of entity delivering strong social outcomes.

They are similar to commercial businesses in being dynamic, using many business techniques and generally having some form of income from the provision of a service. But they are also similar to charities in having social outcomes as fundamental objectives.

So it often happens that they look like charities to commercial businesses, but look like businesses to charities.



Photo: May Lee Weernink. Copyright Auckland Festival of Photography

They are difficult to define precisely as they use various forms and are involved in many different sorts of activities, but there are a number of characteristics which they tend to share:

- They have social goals which are fundamental to their objectives
- They often generate income directly from some of their activities – this usually means that a significant part of their income comes from a service they sell in some way
- They require capital – working capital, capital to acquire assets and capital to implement projects
- They usually make a surplus from their operations – and need to if they borrow to generate the funds to repay a loan
- They may be profit-seeking or simply make a sufficient surplus to service and repay borrowings
- They may be a charity, or a company owned by a charity, but they can also be a normal limited company
- They are generally managed like a business using techniques such as business and operational plans
- They usually have an entrepreneur or a small entrepreneurial group which has created the organisation.

CAPITAL FOR SOCIAL ENTERPRISES

Social lending and investment has arisen in parallel to the rise of social enterprises, providing the capital and investment that they need. Social investment also tends to sit between commercial loans and investment, on the one hand, and charitable grants and donations, on the other. They are also a distinctive sort of arrangement.

Social lending uses many of the disciplines of commercial lenders and only works where it is undertaken rigorously ensuring loans are repaid and serviced. But it generally provides funds where commercial lenders would not and often at lower interest rates.

The development of social enterprise and lending has been substantial overseas and can now show a long and successful track record, but it is relatively undeveloped in New Zealand.

Internationally, this was led by specialised social lenders with foundations becoming involved over the last ten years. Reasonable estimates are that about 20% of endowed foundations have some involvement. Where they are active, they typically devote about 5% of their endowment to loans.

In New Zealand, two community trusts – Southland and Canterbury – have about ten years successful experience but have kept this as a small part of their overall activity.

Some local councils have also offered local groups loans on soft terms. For example Christchurch City Council has run a Community Organisations Loan Scheme for some years as part of its general community funding activities.

There is also a small financial company, Prometheus Finance, devoted to social lending and operating similar to the social banks seen more extensively abroad.

Commercial banks have shown little appetite. It seems likely that social lending will be led by the foundations.

Foundations should consider this for a number of reasons:

- Increase their impact by extending their reach both in amount and type of project
- Allow successful projects to achieve greater scale
- Build stronger projects by improving a project's management

‘There are some reasons to be cautious and foundations should consider carefully whether they are ready to undertake social lending.’

- Provide better focus on long-term operational sustainability in projects
- Allow projects to acquire assets
- Avoid the weakening of a project through inappropriate grants
- Help build social markets
- Allow systematic interventions where a mixture of loans and grants are needed.

Some of these are a benefit to individual foundations themselves but some represent a wider societal benefit.

A NEED FOR CAUTION

There are some reasons to be cautious and foundations should consider carefully whether they are ready to undertake social lending:

- A lending foundation must be willing to foreclose where a borrower fails
- Is there demand for social lending?
- Is there the right culture and adequate capacity in potential borrowers?

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- Is there the right culture and adequate capacity in the foundation itself?

Of these, the willingness to foreclose on a failing borrower is the most important and difficult but without it lending schemes are likely to go badly wrong.

SUB-CONTRACTING ADVISED

If a foundation decides it does want to take this up, unless there are special circumstances, it would be well-advised to sub-contract the management of the lending to an experienced provider. To undertake it itself would require a substantial internal investment and mixing the different disciplines and culture of lending and grant making.

However, it could be that a larger foundation decided to do this and sub-contracted the service to other foundations. This would help cover the investment and allow concentration of lending expertise. In the absence of that, there are three main possibilities:

1. A commercial bank is contracted

There are no banks currently willing to do this, Although this may change if they were approached directly. However, overseas experience suggests this is unlikely to work well as banks don't share the objectives of the foundations.

2. An existing social lender is contracted

This has been done successfully overseas. The only candidate in New Zealand would be Prometheus Finance and this would require it to extend its operations and expertise.

3. A new special purpose agency is created by foundations working together

This would be new and untested and incur heavier costs in starting up, but would be under the foundations' direct control.

IN CONCLUSION

New Zealand has not kept pace with the international development of social enterprise and lending. Other countries have seen many benefits in developing both, but foundations are well-placed here to take the lead on this. There are strong reasons for them individually to take it up, providing they have worked

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Photo: Dennis McCallum. Copyright Auckland Festival of Photography

through carefully some of the difficulties they are likely to face. If they want to proceed, their best way forward would be through some form of sub-contracted management.

There are strong reasons to implement social lending which will increase a foundation's financial and organisational reach and capacity, help to promote social enterprise in New Zealand, and provide more appropriate funding for certain types of project. These present benefits to the foundations themselves, to their projects and to the wider social economy in New Zealand.

However, individual foundations need to consider very carefully their capacity and desire to do this. It is a fundamentally new type of activity and would require some substantial changes both to a foundation's culture and capacity to manage it properly. It's likely to present new types of challenge in the future and it does involve risk.

So, while the argument to see it developed more generally might be accepted, an individual foundation's own decision might be not to proceed, or at least not to proceed until others have tested the ground and there's already wider acceptance and understanding of how it can be done.

■ ABOUT THE AUTHOR ■

This report was commissioned by the ASB Community Trust and The Tindall Foundation. It was produced by Glen Saunders in October 2009.

Glen Saunders, spent several years as Managing Director of European bank Triodos Bank and has experience in global investment markets and socially responsible investment.

For further information contact: ASB Community Trust, 50 Ponsonby Road, PO Box 68-048, Newton, Auckland; Phone 09 360 0291 or 0800 272 878;