Manager
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By email: socialimpactinvesting@treasury.gov.au

RE: SOCIAL IMPACT INVESTING DISCUSSION PAPER

Dear Manager,

Who we are

We are private individuals with a keen interest in establishing a social impact investment venture capital fund in Australia. We believe that using the venture capital approach to invest in and fund new, innovative and proven social enterprises will go some way to tackling some of the most intractable problems in education, unemployment and homelessness. There is a pipeline of tried and tested social enterprises here and overseas that with the right funding level and mix can be nurtured to achieve their social impact goals whilst providing a financial return.

1. ***Michael Fieldhouse*** is Director of Emerging Businesses & Federal Government at Hewlett Packard Enterprises ("HPE"). Michael is a pioneer of adapting an overseas social enterprise model to Australian conditions in the highly successful Dandelion Program he established in HPE's Adelaide offices. The Dandelion Program uses the concepts, ideas and disciplines developed by Danish company Specialisterne, and is an innovative, ground breaking, employment program for persons on the autism spectrum. As at the end of 2016 the Dandelion Program had 56 full time HPE employees working on testing software for the Department of Human Services, Department for Immigration and Border Protection and cyber security projects for the Department of Defense.
2. ***Catherina Toh*** is a financial services lawyer with her own advisory practice and an independent non-executive director. She has served as board member in the nonprofit, philanthropic and government sectors for over 10 years. Her current appointments include one of Australia's leading providers of social services and early social impact investors and a social enterprise with a $150 million annual turnover in the disability services sector. Catherina's advisory practice includes venture capital and private equity managers and investors. In 2014 she was one of the founding partners and inaugural board chair of venture philanthropy organisation Social Venture Partners Melbourne.

Our Submission

Thank you for the opportunity to comment on Discussion Paper. We set out below our comments to some of the questions raised in the Discussion Paper.

1. *What do you see as the main barriers to the growth of the social impact investing market in Australia? How do these barriers differ from the perspective of investors, service providers and intermediaries?*

A. Lack of financial value capture models

Current government funding models are determined according to the cost of service delivery. The costs are often determined on the basis of the costs to the service provider to deliver the services. Payment is tied to the service provider meeting service delivery KPIs (which are not necessarily outcomes-related).

There is little or no focus on the value of the service being delivered, let alone putting a monetary figure on that value. A service that produces intended social outcomes will often also produce a financial benefit for government. For example:

- Stable housing enabling previously homeless person to rebuild their lives with flow on financial savings for the government and reducing demand for expensive emergency short term support services.
- Increased work participation for a person with a disability and receiving a welfare/disability benefit.
- Increased employment prospects for students in VET studies.
- Reduced welfare payments for single parent or long term unemployed by increased work participation.

Some financial modelling work for value capture of social impact has been done in the context of social impact bonds where returns are dependent on the service provider meeting social impact goals. This work needs to be extended to other funding scenarios so financial value capture models can be used more broadly and widely, expanding the potential investment universe for social impact investments.

Investors	Lack of information and clear and transparent financial modelling on potential returns means a reluctance to invest.
Service Providers	Inability to get funding, additional funding or expansion capital if the financial value capture model is not well understood or accepted by investors and funders.
Intermediaries	Recommendation of social impact investing outside of social impact bonds is high risk and difficult without general industry accepted financial value capture models.

B. Access to Federal Government data

There is a wealth of data held or controlled by the Federal Government, its agencies and departments that is pivotal to the development, design and implementation of social impact programs and the social impact investment market. Access to appropriate levels of data is required to inform:

- Conceptualization and detailed business planning for social ventures
- Defining the target cohort for social impact intervention
- Innovative solution design and outcome measurement.

C. Nonprofit legal structures, investment capital and investment pipeline

Service Providers currently realistically have access to two forms of capital to fund their operations – "grants" (including donations and bequests all considered as income) and "debt". There is very limited equity available and without equity it is very hard unlock debt. There is also not sufficient nuance in tailoring the capital needs to the type of venture. For example:

a. High risk – venture capital for ideas that might not have cashflow
b. Medium risk – expansion capital for ventures that have business model and/or income stream.

The legal structures and framework for service providers, most of whom are nonprofits and registered charities, have prohibitions on the return of capital or payment of income to any party (and for good reason). We would not want to see the erosion of this protection against the misappropriation and misuse of charitable funds but some consideration needs to be given to streamlining the legal requirements to enable nonprofits to participate in the impact investment space.

The limited investment capital available for social impact investment is linked to the shortage of investment grade social impact investments available. At the present time, there appears to be insufficient investment opportunities that make it through to investors. There are also a limited number of investors who are willing to forgo some investment return in exchange for achieving social impact goals.

Investors	Lack of investment grade impact investments in the pipeline.
Service Providers	Legal structure for charities prevents direct provision of social impact investment opportunity or access to investment capital other than in the form of a grant. Cost and expense of having to set up and maintain separate structure for social impact investment purposes.
Intermediaries	Highly complex and specialised advisory on both the investor and service provider ends. Lack of readily available expertise to structure social impact investment opportunities and to advise investors.

2. *What do you see as the future for social impact investing in Australia: for example, can you foresee the development of new structures for social impact investing?*

The Federal Government's "Try, Test and Learn" fund ("TTL Fund") will spark some interest in the idea of social impact. In particular, it will encourage the focus on robust evaluations and evidence based decision making in funding social services. The TTL Fund, however, is a grant as opposed to an investment fund and is limited in its ability to address the challenges facing successful ideas of achieving scale and establishing sustainability in their business models.

The future for social impact investing in Australia lies in the establishment of social impact investment venture capital funds that will be critical to fostering innovation and growth of social impact investments – as social enterprises or through the issue of social impact bonds. Without the establishment of venture funds able to provide venture capital to new social innovation and expansion capital to existing operations, it will be difficult for the social impact investing market in Australia to grow or mature. Without established funding sources there will be limited social innovations being trialed leading in turn to a limited number of willing investors/funds and vice versa.

We believe as the social impact investment market matures we will see the growth of independent innovative funds able to identify and foster social enterprises that are disruptors dramatically changing service delivery or expected outcomes. With the growth of social venture capital funds and the social impact investments to invest in we believe that social impact investments will become more mainstream and provide an alternative investment class for institutional and retail investors with an ethical bent.

<u>We risk arresting the growth and development of the social impact investment market in Australia if </u>social impact funds that are established largely cater for the existing players in the market as this will limit competition and the fostering of greater innovation. We also need to ensure that funds do not only focus on providing one type of capital e.g. expansion capital, as this would leave a funding gap in the market for venture funds for social enterprises

3. *Are there any Australian Government legislative or regulatory barriers constraining the growth of the social impact investing market?*

Uncertainty about the taxation status of social enterprises, social impact bonds and social impact venture capital funds is a major stumbling block in the growth of the market. This is particularly where there is involvement by a party that has charitable status. The likely roles a charitable institution could play in social impact investing include parent company of a social enterprise, issuer of social impact bond and investor in social impact venture capital fund.

Taxation status will also drive the structuring of social impact venture capital funds and clarity in how various structures will be treated from a taxation perspective will help remove what are currently regulatory and financial barriers to entry. In particular, we believe there should be clarity about the ability of social impact investment funds to access to the tax incentives that are available to Venture Capital Limited Partnerships, Early Stage Venture Capital Limited Partnerships and investors in early stage innovation companies. If there are no tax incentives that are available to social venture capital investment funds this would severely constrain the growth and development of such funds. We believe that tax benefits that attract capital and encourage investment similar to the New Markets Tax Credits (NMTC) program in the United States warrant consideration particularly for those funds that will focus on harder social issues and/or priority impact areas.

4. *What do you see as the role of the Australian Government in developing the social impact investing market?*
   We believe the Australian Government has a number of roles to play.

Market marker	Helping social funds to establish themselves, through provide appropriate funds
Market regulator	Helping to define standards and promote competition and innovation.
Consumer of social impacts	Being consumer of impacts, defining social priorities and development of payment structures and mechanisms for social impacts/outcomes.
Market communicator and integrator	Assist with relationship, communication and cooperation across level of Government where social impacts need to be made. Particularly gaining access to appropriate data.
Access to data	Providing access to the appropriate to assist social innovations and enterprise with develop business, intervention and measuring the outcomes

5. *Do you see different roles for different levels of government in the Australian social impact investing market? For example, the Australian Government as co-founder with State and Territory Governments continuing to take the lead in developing social impact investments?*

   We believe the Australia Government should be responsible for setting up the framework, policies and regulations for the social impact investment market so there are no inter-state barriers or incentives that skew the development of the market to particular jurisdictions within Australia. This lessens competition and may draw innovation, capital and services away from areas that most need it.

   The Australian Government should also bring the State and Territory Governments (through their respective Social Impact Units) together on issues of policy, markets and investments so there are consistent government approaches to the issues and all levels of government are supporting the development of social impact investing.

   The development of social impact investments should fostered within each of Australian Government and State & Territory Governments given the different beneficiaries, size of the impact and different social priorities and responsibilities.

   Funding of social impact investments or social impact venture capital funds does not necessarily all have to be obtained from the Australian Government. State and Territory Governments (individually or collectively) should be able to contribute an appropriate level of funds and provide assistance and support aligned with the benefit (social impact) they will receive. In some circumstances, it may be appropriate for the Australian Government to provide a leadership role in facilitating involvement and contribution from the States and Territories, for urgent social priorities of national interest, for example, impacts associated with "Closing the Gap" report.

It should also be noted that the role of government is supporting impact investing is not confined to it providing funding, assistance or liaison support. Government can also support impact investing by procuring services through social enterprises thereby supporting the trading activities of the entities. For example, the Australian Government departments that have contracted services from the Dandelion Program at HPE, or arranging catering services through a social enterprise providing training and employment like the Asylum Seekers Resource Centre Catering.

6. *Are there areas where funding through a social investment framework may generate more effective and efficient policy outcomes than direct grant funding?*

Unlike direct grant funding which is focused on what services are to be delivered, a social investment framework's focus is on what benefits may be realised and what the outcome for the recipient is. The focus on finding solutions for problems rather than continuing to fund programs encourages innovation and the undertaking of research and evidenced based solutions. In many instances this leads to more effective and efficient policy outcomes than traditional direct grant funding.

We believe that a social impact investment framework is better suited to social entrepreneurs developing social impact solutions to achieve superior policy outcomes due to:

- Navigating the grants application process including identifying appropriate grantors is complex and time consuming. Pulling together grant applications requires skill and experience which social entrepreneurs rarely possess resulting in low success rates.
- The grants acquittal and reporting requirements from grantors can be onerous and crippling - distracting the social entrepreneurs from their core purpose.
- Social enterprises, especially at invention or start-up phase or with no local track record, will be deemed too risky for many grantors and be unable to attract any funding.
- Even ideas that are initially kicked-off by grants find there is very limited venture and expansion capital to develop and/or to attract initiatives from overseas.

7. *What Australian Government policy or service delivery areas hold the most potential for social impact investing? Are there any specific opportunities you are aware of?*

- Disability employment models:
  - Ultra Testing (www.ultratesting.us): high quality software testing services through exceptional onshore teams that include individuals on the Autism Spectrum. We deliver a full suite of quality assurance and testing for digital campaigns, websites, mobile apps and enterprise platforms, and our competitively priced services can be engaged on an as-directed basis or via retained teams.
  - Rising tides car wash (www.risingtidecarwash.com): successful carwash business that employs people with autism for their talents (attention to detail, loyalty,

ability to do repetitive tasks etc.). They are in top quartile of profitability of car washes.

- <u>Bridge Ventures (www.bridgesventures.com)</u>

  Bridges Ventures was founded in 2002 with the vision that hands-on investment and entrepreneurial talent can be used to address some of the challenges facing our society, as well as drive sustainable growth. They have investment vehicles across three main fund types – Sustainable Growth Funds, Property Funds and Social Sector Funds

  - Sustainable Growth Funds have a strong track record of supporting entrepreneurs and building businesses that can excel both commercially as well as create positive impact.
  - Property Funds invest in properties in regeneration areas and those showing environmental leadership.
  - Our Social Sector funds provide finance and support to charities and social enterprises delivering services with high social impact.

  Investment example:
  Employment among 16-24 year-olds is creeping up, but it still lags behind pre-financial crisis levels. Over 940,000 young people are currently classified as 'NEET' (not in education, employment or training), which equates to 1 in 7 of all 16-24 year-olds. The skills gap in many sectors of the UK economy is hampering full economic recovery. One in five job vacancies remain unfilled because of this gap.
  Babington Group, founded in 1974, provides high-quality apprenticeships and training courses, from accountancy and financial services, to sales and marketing, to health and social care. The Bridge team helped management to identify and execute two bolt-on acquisitions and supported them during the integration process. Since the investment, Babington has supported over 32,000 learners – helping over 3,700 formerly unemployed people to find jobs.
  (http://bridgesventures.com/bridges-exits-apprenticeship-provider-babington-group-strong-growth/)

- <u>Social Innovation Fund (USA) Investment example</u>

  Social Innovation Fund invested in Corporation for Supportive Housing (www.csh.org) to expanding and replicating supportive housing models that combine health, housing and social services to improve the health and housing outcomes from homeless individuals with complex health needs who frequent multiple public crisis systems.

  - Benefits realized: Average overnight hospitalizations dropped from 8.5 before housing to 2.7 in the 12 months post-supportive housing placements; Average emergency department visits decreased from 13 pre-housing to just 5 in the 12 months post. (http://www.csh.org/2016/04/celebrating-sif-success-in-ct/)

8. *Are there opportunities for the Australian Government to collaborate with State and Territory Governments to develop or support joint social impact investments?*

Potential opportunities for collaboration:

- Establishment of disability and employment impact fund to scale existing social impact businesses and attract impact businesses from overseas such as Rising Tides car wash. There is opportunity to work with the State and Territory Governments on social impact employments in the areas of:
    - Disability
    - Youth
    - Juvenile offenders
    - Long term unemployed
    - Refugees.

- Affordable/social housing aimed at low income earners, welfare recipients and people with severe disabilities.

  We believe it is key to combine some these social impacts and businesses together to greater impact for example funding affordable housing and establishing social businesses such as a construction and maintenance businesses that employ people that have disability, youth, long term unemployed, refugees to participate in the building of new affordable housing. Funding to creating and attract local social enterprises connected to the new housing communities such as bakery café aimed at providing employment and work experience, training and skills needed to participant in the workforce targeting people with disadvantage and/or at risk. The social impacts achievable in this combination would be in reducing crime and welfare and increasing employment participation and quality of life.

9. *What are the biggest challenges for the implementing the Australian Government's public data policy in the social impact investing market? What can do the Australian Government do to address these challenges?*

The key challenge is to establish a single point of contact across the Australian Government to assist enterprises, intermediaries and investors to obtain the data they need to conceptualise, design, implement and monitor the impact they are trying to make or fund. Presently, relevant data is fragmented across layers of Government, government agencies and departments making it hard obtain a full picture of the issues and to monitor and measure outcomes.

Establishment of a social impact investment unit of the Australian Government would:

- Establish a data sharing plan for across Governments and departments for specific social priority areas – what data, frequency, duration, naming, indexing, privacy protocols, etc.
- Help pull the necessary that data together across departments, agencies and layers of Governments into a single data archive.
- Manage requests for data from the public including enterprises, intermediaries and investors.
- Monitor and manage usage of the data via data enclave.
- Implement and manage data use contractual arrangement with the users.

Note: All data should be anonymized and accessed by the users under a contractual arrangement (that includes privacy protocols) to ensure the data accessed is used appropriate to the purpose defined on the request.

A suggestion would be to establish a data sharing arrangements for specific social priority areas within Government(s) to make implementation as simple as possible initially.

10. *Are there opportunities for the Australian Government to form data sharing partnerships with State and Territory Governments, intermediaries and/or service providers?*

To improve the development of social impact investments access to data is critical as it helps to identify target groups of need and identify and develop appropriate interventions. The problem is that most data is fragmented across layers of Government, agencies and departments making it hard obtain full picture of the issues.

Some of the opportunities for data sharing are:

- Youth employment – data determining skill shortages and employment demands within city and regional areas
- Disability employment – data to determining skill shortages and employment demands within city and regional areas
- Affordable housing – data to define areas of shortages and priority target groups (e.g. homeless, people with severe disabilities, newly settled refugees).

11. *We are seeking your feedback on the four proposed Principles for social impact investing.*

A. Value for Money

"Value for money" is already a principle that underpins the procurement of services by governments at all levels. The social impact investment space where understanding, and being able to measure, the impact of outcomes including the flow on financial impacts, are crucial to obtaining funding support, provides government with the transparency and hard data necessary to comply with this principle. Other investors will also want "value for money" from their social impact investment not necessarily in the level of financial return but also in the extent of the direct and flow on social and financial benefits resulting from their investment.

B. Robust Outcomes-Based Measurement and Evaluation

The outcomes of social impact investments must be measurable, quantifiable, able to be costed and underpinned by sound research principles. The measurement of impact is a growing and evolving discipline with some tools already in use in Australia (e.g. NDIS Social Impact Measurement Toolkit).

The Federal Government is well placed to provide leadership in the development of generally accepted measurement and evaluation principles (akin to the generally accepted accounting principles for financial statements). Support of social impact investments should also factor in the costs of undertaking research and development, particularly for new or early stage social enterprises.

C. Fair Sharing of Risk and Return

The Federal Government's "Try, Test, Learn" Fund ("TTL Fund") is intended to encourage research based innovation and creativity in social service program delivery so that new, workable solutions are found for intractable social problems. Under the TTL Fund, financial risks still rest 100 percent with government (providing funding as grants).

In a social impact investment scenario, government would share financial risk with other investors and/or the service provider, in some instances shifting the full financial risks to investors and/or service providers. Given that government potentially will take the largest share of the financial benefits of the successful social impact investments (e.g. including through lower welfare payments or Medicare costs) a fair sharing of risk and return would suggest that government should also bear some of the financial risks up front.

A distinction could perhaps be drawn between new and early stage social impact enterprises requiring start up funding similar to that available through the TTL Fund and later stage, more mature enterprises that require expansion capital. In the latter case, it may be more appropriate to look to investors and/or service providers to bear the financial risks.

D. A Deliverable and Relevant Social Outcome

While the government will naturally focus on social impact investments in its areas of priority (e.g. social housing), its support for the development of social impact investing in Australia should not be so confined. We would advocate broad support for social impact investing across all government portfolios and an openness to engaging with the sector and the market.

Social entrepreneurs are innovating and developing solutions here and overseas across a whole spectrum of social issues and we will lose the ability to cross-fertilise, harness these ideas, adapt them, learn and grow the sector if we limit our focus to a priority list. A strong, sustainable impact investing eco-system is only possible with a breadth and depth of ideas and solutions.

21. *If the Government were to amend any of these definitions to provide clarity for PAFs, would there be any consequences for other activities regulated by the Corporations Act, or other Commonwealth legislation?*

Whilst we agree that it is appropriate and desirable to encourage the investment in social impact investments by PAFs, we believe protections inherent in requiring investors to be "sophisticated investors" should not be removed without consideration to the size of the PAF. Impact investments as an asset class are riskier and less liquid than other investments a PAF may make (e.g. listed equities and cash and fixed income investments). The failure rate of social enterprises is high and the need for top up capital to remain as an ongoing can quickly drain large capital pools.

A PAF which does not by itself meet the "sophisticated investor" test may not be in a position to invest other than a very small proportion in an impact investment. The trustee may otherwise risk breaching the Private Ancillary Guidelines 2009 in relation to investment strategy and distribution obligations and the prohibition against carrying on a business.

23. *What guidance in particular would provide a desired level of clarity on the fiduciary duty of superannuation trustees on impact investing?*

APRA's confirmation that a superannuation trustee can include ethical investments in a superannuation fund provided it meets the requirements of section 52 of the SIS Act and is in the best interests of members should be sufficient clarity.

A decision to invest in an impact investment must first and foremost stack up on investment grounds (the likely return, risks, diversification, liquidity, valuation, etc.) and the trustee must determine that it is a suitable investment for the fund and its members. We do not believe that impact investing requires special or additional rules that the trustee needs to consider compared with any other investments. In particular, new and start up social enterprises, would be very similar in investment characteristics as a venture capital or private equity investment and if the trustees already invest in these categories then they should apply the same rules of assessment and consideration.

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