Reaching Underserved Markets

The Role of Specialist Financial Intermediaries in Australia

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The views expressed here are those of the author and do not necessarily represent the views of the commissioning organisations, Foresters Community Finance and Social Traders.

This Report Was Commissioned By

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Acknowledgements

Thanks to Belinda Drew (Foresters Community Finance) and David Brookes (Social Traders) who commissioned this work, helped to scope it out, made links to potential interviewees and coordinated the editing and production processes. Thanks also to Laura Clayton (Foresters Community Finance) for research assistance; and to Mark Daniels, Libby Ward-Christie (Social Traders) for valuable feedback.

Special thanks to all those who agreed to be interviewed. We have maintained anonymity of interviewees as we asked for honest accounts of stakeholders engagements with underserved markets and intermediaries. We hope that interviewees will, however, recognise their voices and benefit from reading the report in the same way we benefited from their honest and open reflections. Thanks also to Julia Sass Rubin for sharing her insights into the state of intermediaries in the US.

Disclaimer

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Foreward

This report comes at an important time in the evolution of the social finance market in Australia. It explains the nature and complexity of underserved markets both from a supply and demand perspective. A detailed analysis is provided into the critical role that intermediaries play in relation to social enterprises.

The issue of underserved markets is significant with an estimated 15% of Australians excluded from mainstream financial services.

Intermediaries are not new – peak bodies, industry associations and finance providers are also intermediaries. In fact in many ways they are critical to the success of transactions in the mainstream markets. Yet the role of specialist intermediaries working in the social enterprise and not-for-profit sectors is relatively new and not well understood in Australia.

"A firm or person (such as a broker or consultant) who acts as a mediator on a link between parties to a business deal, investment decision, negotiation, etc. In money markets, for example, banks act as intermediaries between depositors seeking interest income and borrowers seeking debt capital. Intermediaries usually specialize in specific areas, and serve as a conduit for market and other types of information." www.businessdictionary.com

This paper highlights the need for multidimensional responses and tailored intermediation, which involves building supply and demand capability at different lifecycle stages of social enterprises. In the last 3-5 years, we have seen the emergence of a range of intermediaries as well as an increase in the supply of capital for social enterprise, via the establishment of the three Social Enterprise Development & Investment Funds in Australia.

Foresters Community Finance (Foresters) and Social Traders have been engaged in the social enterprise and non-profit sector as intermediaries over many years - providing capacity building, start up funding, finance and investment. This report reaffirms the view of both our organisations on the priority need of building a pipeline of investment-ready social enterprises to access the capital that is now available from the SEDIF's and other social investment sources.

We would like to express our gratitude to Ingrid Burkett, the author of this report, who once again has done an exemplary job in analysing and providing practical insight into what is a complex challenge.

We commend the report to you as a timely contribution to inform the evolving social finance and investment scene in Australia

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Executive Summary

In Australia there are people, groups and organsiations who are currently excluded in significant ways from accessing and using mainstream financial services and products. They represent 'underserved' markets, lacking access to capital, particularly affordable credit.

These underserved markets include individuals and families (with some reports estimating that up to 15% of Australians are excluded from mainstream financial services); non-profit organisations; social enterprises and social businesses; and many small to medium sized enterprises (SMEs). Financially excluded and underserved markets have fewer opportunities for growth and development, and therefore fewer pathways out of marginality and disadvantage.

This report explores and clarifies the roles of specialist financial intermediaries in unlocking access to capital and investment in underserved markets in Australia. These intermediaries include Community Development Finance Institutions (CDFIs) and specialist investment-readiness intermediaries focussed on ensuring that underserved markets have the capacity and capability to take on and manage capital.

Part One of the report provides an overview of underserved markets in Australia and outlines the critical roles played by specialist intermediaries to reach into these markets. It proposes that there are a range of intermediation roles and processes required across both the demand and supply-sides of the market in order to address the financial exclusion of underserved markets.

Part Two of the report provides more detailed insights and analysis into the roles and challenges of specialist intermediaries in one underserved market in Australia, that of social enterprises. This part examines three key roles of intermediaries operating in this market - building investment-readiness; providing demand-led finance opportunities; and growing and balancing the supply of capital aimed towards social enterprise.

Part One: Understanding and Engaging with Underserved Markets

Underserved markets can be explained as representing a market failure. More complex than this, however, they also exist because of structural inequities, and are perpetuated though biases and assumptions on both the demand and supply-sides of the market. On the supply-side assumptions are often made about the appropriateness of capital and the capacity of people, organisations or enterprises in underserved markets for holding and managing capital. On the demand-side, people and organisations can self-exclude either through lack of knowledge or negative perceptions about the relevance or appropriateness of capital to their situations.

Paradoxically, it is not the case that NO market responses exist in underserved markets, but rather that responses tend towards being one-dimensional. Sometimes this can mean that such markets are actually 'over-serviced' in certain ways, which can crowd-out alternative opportunities. So, for example, in relation to financially excluded individuals there has been a rapid growth of 'predatory' and fringe financial services, leading to an over-servicing of this population at the same time as other financial services remain inaccessible or unavailable.

The purpose of specialist financial intermediaries is to redress the market failure, structural inequities, biases and assumptions, and the one-dimensional overservicing of underserved markets, on both the demand and supply-sides of the market. They do this by:

- ***Building*** capacities and capabilities on the demand-side of the market, and increasing awareness and access to information on the supply-side.
- ***Bridging*** gaps between the needs and capacities on the demand-side and appropriate financial services and products on the supply-side.
- ***Brokering*** between stakeholders across the supply and demand-sides of the market to ensure that capital can flow into underserved markets and that as a result social and economic impacts can be generated.

Engaging with underserved markets requires more than just 'add capital and stir'. It is not simply about applying mainstream banking and finance skills to new markets.

Intermediaries engage with underserved markets on both a ***transactional*** level (opening access to financial services and products) and a ***transformational*** level (ensuring that access leads to real impacts, opportunities and pathways out of exclusion in underserved markets, not merely greater levels of debt).

This means that specialist financial intermediaries blend well developed investment and financial skills, with a deep understanding of underserved markets, AND, importantly, with community development methodologies and technical assistance skills.

Part Two: Intermediation in Action - Financing Social Enterprise

Research in Australia and internationally suggests that social enterprises face significant barriers to accessing debt and equity capital to start, develop, grow and scale. The barriers exist on both demand and supply-sides of the market. Barriers include not only the investment-readiness and capacity of social enterprises, but also their cultural readiness and legal structures, the availability of affordable capital and the understanding financial institutions have about social enterprise business models.

Currently grant capital still dominates the social enterprise sector. The Social Enterprise Development Investment Fund (SEDIF) initiative has increased opportunities for social enterprises to access debt capital. Equity capital is still very limited in this sector due to a lack of awareness and demand, but also because most social enterprises are not structured to be able to attract or accept equity.

Social enterprises have different needs for capital across their lifecycle, and different types of capital may be more or less appropriate at different times or for different social enterprise structures. What is important is that there are coherent and coordinated entry-points and pathways towards diversities of capital for social enterprises across their lifecycle, ensuring that they do not become stuck with access only to one form of capital such as grants.

In Australia there is a less well developed intermediary sector than there is in places like the UK and USA. However there are several key intermediaries that have some focus on finance, in relation to assisting enterprises to become investment-ready and/or offering stepping-stone capital in the form of repayable grants, or in providing specialist tailored finance into this sector.

Analysis of the interviews and literature in this research points to three key interconnected roles of specialist financial intermediaries in relation to social enterprise.

1. ***Building investment-readiness***
   International research suggests that investment-readiness represents a significant barrier to growing the social enterprise sector and to ensuring its access to capital. In Australia, though there has been some support for investment-readiness intermediaries, this has been somewhat limited both in terms of reach and scope. Now that the supply of capital has increased (through the SEDIF specialist funds), growing the pipeline of investment-ready social enterprises in a coordinated and intentional manner has become a priority.

2. ***Providing demand-led finance opportunities***
   Specialist social finance intermediaries assess loans to social enterprises using commercial terms - they are not subprime loans, and they are made using risk management criteria that would be recognisable to mainstream financial institutions. What differs is the process used to work through an assessment, the level of tailoring, the nature of the feedback given to an enterprise and the time taken to walk through and work through the loan process. Specialist intermediaries ensure that capital is not only accessible to social enterprises, but that it will actually lead to real impacts, that is, greater viability and sustainability of social enterprises.

3. ***Growing and balancing the supply of capital focussed on social enterprise***
   There are three key intermediation roles in relation to building the supply of capital: growing and diversifying the supply of capital; ensuring a match between supply and demand to avoid a supply-driven push of capital; and developing effective ways to measure and share outcomes and results with investors and the sector as a whole.

   In Australia the roles of intermediaries in relation to the financing of underserved markets have not been well understood, or they have only been understood in terms of their transactional functions. Recent Federal and State Government initiatives to build the supply of capital into a number of underserved market areas has highlighted the need for greater investigation of how intermediaries actually work to bridge and channel this capital so that it achieves the social policy goals that underpin these initiatives. What this research demonstrates is that success in relation to these goals will be based not only on how intermediaries structure their transactions in these markets, but on how successfully they are able to enact transformation, such that the people, groups and sectors on which they are focussing will actually develop real and lasting capabilities and opportunities from engaging with finance.

This report serves as a way to extend the current dialogue and debate about the roles of specialist financial intermediaries in Australia with the goal of ensuring that they develop as a sustainable and valued part of the social investment landscape.

Introduction

This report is focussed on clarifying the role that specialist financial intermediaries play to unlock access and channel capital and investment into underserved markets. Underserved markets in this report refers to those people, groups and organisations who are currently excluded in some significant ways to accessing and/or using capital, mainstream financial services and products.

The reason for undertaking this research is focussed on questions raised in Australia and internationally recently about whether indeed there is a need for specialist intermediaries to reach underserved markets, or whether it is preferable for mainstream financial service providers to be enticed to enter such markets.

This research, therefore, sets out to articulate the role of specialist intermediaries both on the supply and demand-side. It aims to explore how such intermediaries operate and explore in greater depth why they are needed to drive impacts, particularly in underserved markets. While it is recognised that there are a growing number of what could be termed 'intermediaries' in the broader social impact and service delivery area (focussed on enhancing the impact and effectiveness of social sector organisations and social enterprises for example), this paper focusses specifically on those intermediaries associated with finance and investment in relation to social impact.Further, in focussing on finance and investment this paper makes a clear distinction between 'finance' and 'funding' (with the former requiring repayment and involving a cost usually in the form of an interest rate, as opposed to the latter, which is usually not repayable and does not incur a direct monetary cost on the part of the recipient); and distinguishes 'investment' and 'philanthropy' (with the former implying a financial return to the investor). This focus is depicted in Figure 1 (see page 10).

Methodology

This report is based on two key research processes:

1. ***Literature research:*** A detailed review of Australian and international literature relating to the role of intermediation in reaching underserved markets;
2. ***Primary research:*** In-depth interviews with 18 key stakeholders in Australia's emerging social investment and social finance landscapes. These included leaders of intermediaries; stakeholders in underserved markets; government; financial institutions; investors and financial advisors. Some leaders in intermediaries in the United States and the United Kingdom were also consulted to explore how the role such organisations have played in other contexts. Quotes from the Australian interviews are included as part of this report to provide different perspectives or to deepen understanding of particular issues. All identifying information about interviewees has been kept confidential, with quotes only indicating which part of the sector the interviewee comes from (ie. intermediary, stakeholder, government, investor, financial institution or advisor).

Part one of the report examines what is meant by 'underserved markets', and explores how specialist intermediaries provide a bridge into such markets. This section provides an overview of the range of factors that lead to the creation of financially underserved markets, and identifies a number of underserved markets in the Australian context. The role of intermediaries is also explored, both in relation to mainstream markets and then in relation to underserved markets. Part one concludes with a proposal that there is a continuum of intermediation roles and processes needed along the demand and supply continuum in order to address the financial exclusion of underserved markets.

Part two consists of a more detailed exploration of the roles and challenges of intermediaries operating in one underserved market in Australia - that of social enterprises. Recent initiatives such as the Federal Government's Social Enterprise Development Investment Fund (SEDIF) have stimulated existing and new intermediary activity in relation to the supply of finance (particularly debt finance) to the social enterprise sector. This section explores three key roles of intermediaries operating in this market - that is, building investment-readiness; providing demand-focussed finance opportunities; and growing and balancing the supply of capital.

In overseas contexts such as the US and the UK it is increasingly clear that specialist intermediaries play important roles in bridging the demand for and the supply of capital in underserved markets. Though there are some intermediaries in Australia who have engaged with underserved markets for many years, the intermediary space has recently received increased attention and some catalysing government funding - not only in relation to social enterprises through SEDIF, but also in relation to the financial exclusion of individuals through the Federal Government's Community Development Finance Institutions (CDFI) Pilot Program; and at a State level, with an increased focus on asset building finance for non-profit organisations. This report provides an important insight into the key roles and challenges of intermediaries specifically focussed on underserved markets. The aim is ultimately to expose the need for the further development of these intermediaries in the Australian context.

Part One:

Understanding and Engaging with Underserved Markets

What is an Underserved Market?

An underserved market refers to any part of a market that experiences a lack of access to and/or an exclusion from financial products and services, including those areas that are under-invested. Underserved markets can be viewed from the perspective of:

- ***Deficit:*** Those who are part of the underserved market 'lack' access to the products and services that could provide pathways out of exclusion. In other words, these groups are not served well by mainstream financial services. From this perspective commentators often talk of underserved markets as 'financially excluded' or as needing 'financial inclusion'.
- ***Opportunity:*** Underserved markets are 'untapped' and there are opportunities for the creation of mutual value, whereby benefits could flow to both those on the supply and demand-sides of the market. Some commentators speaking from this perspective have referred to underserved markets as 'emerging' or 'new' markets (see for example, Scorsone and Weiler, 2004), meaning that they have been unexplored to date but have great potential for development. Again, this could relate to either supply or demand-sides. That is, there is potential for engaging 'untapped markets' (see for example, Weiser et al, 2006), but equally there is opportunity for development on the demand-side as some people and organisations either lack knowledge, or they have negative perceptions of financial services, and as a result the potential benefits of such services can remain latent in underserved markets.

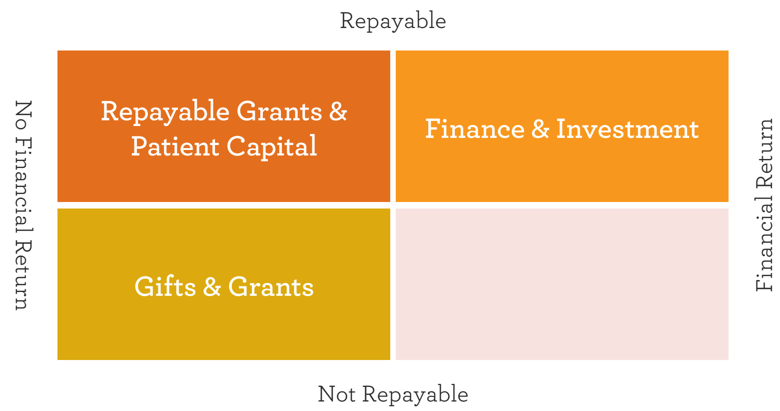
In contrast to 'financial exclusion', the term 'underserved markets' offers more scope for exploring opportunities across a broader cross-section of people and groups who may not have sufficient access to or use of financial services. Financial exclusion often refers only to individuals without certain financial products, such as a transaction account; or those individuals who are underbanked, having no access to incremental credit (see for example, KPMG, 2011) - as one interviewee highlighted:

"when you talk about financial exclusion, particularly with government, they seem to think it's about low income individuals. And they don't see it beyond that. I think in other countries they've got a much broader concept of that term" (Intermediary).

There are a number of other sectors that find it difficult or impossible to access credit (such as social enterprise and non-profit organisations) and there are key sites or groups where exclusion from financial services is more prevalent (such as in particular geographic areas, or amongst particular populations such as Indigenous people, or immigrant groups). In this report, the term 'underserved markets' incorporates a broader understanding of the sectors and groups who lack access to, and are therefore excluded from mainstream financial services and products, particularly affordable credit. In Australia four key sectors represent 'underserved markets' in relation to financial products and services:

1. ***Individuals and families*** who are marginalised or excluded from mainstream financial services, which a recent study suggested could be up to 15% of Australians (Connolly et al, 2011).

Fig 1 *This report is focussed on intermediaries engaged in finance and investment*



2. ***Non-profit Organisations*** who are often unable to access capital for service delivery, asset development and investment (see Senate Economic References Committee, 2011; Productivity Commission, 2010; Burkett and Drew, 2008; Burkett, 2010b).
3. ***Social Enterprises and social businesses*** who are frequently unable to access capital for start-up, growth and development, and also for asset development (see SEDIF, 2011; Senate Economic References Committee, 2011; Burkett, 2010a).
4. ***Small to Medium-sized enterprises (SMEs)*** who are finding it increasingly difficult to access debt and equity capital for work, development and growth (see Healy, 2010; Burkett, 2012).

Size of Underserved Markets in Australia

Table 1 below outlines the size of underserved markets in Australia, with references to relevant research and resources.

Table 1 *Size of different underserved/financially excluded markets in Australia*

Underserved Market	Estimated Size of Market	Source
Financially excluded individuals and families	In 2012, research estimates that in Australia 192,000 people are fully financially excluded and 2,803,000 people are severely excluded.	Connolly, C., Georgouras, M., Hems, L., (2012) **Measuring Financial Exclusion in Australia**, Centre for Social Impact (CSI) – University of New South Wales, for National Australia Bank.
Non-profit organisations	The productivity commission in 2010 estimated that there were almost 58,779 economically significant non-profit organisations, but there is little specific research estimating how underserved this sector is in relation to accessing capital.	Lyons, M., North-Samardzic, A. and Young, A. (2007) *Capital Access of Non-Profit Organisations* , **Agenda**, vol. 14, pp.99-110. Burkett, I. (2010) **Financing the Australian Not-for-Profit Sector**, Foresters Community Finance for National Australia Bank.
Social enterprises and social businesses	Barraket et al (2010) estimate that there are up to 20,000 Australian social enterprises. It is unclear from this report or other research how underserved this sector is in relation to accessing capital, however it is proposed that the majority of these social enterprises are small to medium sized, and therefore it is to be expected that there is a potentially significant number who are underserved by mainstream financial services.	Barraket, J. et al (2010) **Finding Australia's Social Enterprise Sector: Final Report**, Social Traders and Australian Centre for Philanthropy and Nonprofit Studies, June, available at: Burkett, I. (2010) **Financing Social Enterprise: Understanding Needs and Realities**, Foresters Community Finance Research Paper, available at: http://www.socialtraders.com.au/finding-australias-social-enterprise-sector-fases
Small to medium-sized enterprises (SMEs)	According to the Australia Bureau of Statistics, there are over 1.2 million SMEs in Australia. Most of these are 'micro-SMEs', employing less than 5 people. 90% of SMEs in Australia turn over less than $1million. Over 100,000 businesses have an annual turnover of between $2million and $100million. According to a Sensis SME survey undertaken in November, 2011, 41% of SMEs found it hard to access finance, with smaller SMEs finding it harder than larger SMEs.	CPA (2010) **Access of Small Business to Finance**, CPA Australia's Submission to the Senate Economics References Committee Inquiry into Access of Small Business to Finance, Australia, May Burkett, I. (2012) **Place-based Impact Investment in Australia**, Collaborative Report for DEEWR, NAB, JBWere and Mission Australia, available at: http://deewr.gov.au/place-based-impact-investment-australia

Differences and Similarities Across Underserved Markets

While this paper explores the role of intermediaries across a spectrum of underserved markets, it should also be recognised that there are profound differences across and within these markets that will shape any responses designed to address financial exclusion. However, the purpose of this paper is not to explore these markets in depth (though we recognise the need to do this, and the efforts made by others to undertake such analyses), but rather, to argue that if we want to address the financial exclusion of any of these groups, specialist intermediaries can play key roles in this process.

We also, however, recognise the criticisms that have been leveled at researchers who do not recognise the differences between underserved markets and who:

"treat all underserved communities as interchangeable, not acknowledging that they differ in important ways in the nature and causes of their capital constraints. These differences matter very much for framing an appropriate response to the problem"
(Rubin, 2010;p.183).

With this in mind, the general points made throughout the paper will be illustrated, wherever possible, with specific examples from a variety of underserved markets and from different contexts. In addition, the second part of the paper, focusses on the roles and challenges of intermediaries developing responses in one specific underserved market, that of social enterprises.

Depth of Exclusion in Underserved Markets

'Underserved market' is a very broad term and therefore it is necessary to highlight that not all financially underserved people, places or organisations are equally underserved or excluded. Further, it should be recognised that there is diversity within not only across underserved markets. For example, in relation to financially excluded individuals, Connelly et al (2011, 2012) identify and have developed indicators around three levels of exclusion - that is, those who are:

- ***marginally*** excluded
- ***severely*** excluded
- ***fully*** excluded.

Equally, in other underserved markets there are different levels or depths of exclusion. Responses therefore need to consider their ***reach*** (ie. the depth an initiative extends to in relation to different levels of exclusion, so that they are reaching out to those who are more severely excluded, not only servicing those who are marginally excluded) in addition to their ***scale*** (ie. how many excluded or underserved people, groups or organsiations are ultimately reached). For the most excluded in any market responses may need to focus not only on direct provision of financial services, but support to develop capacity and capability to step onto a pathway towards access to and participation in such services. This is examined in more depth below.

The Social Purpose of Engaging in Underserved Markets

Breaking Cycles of Underinvestment and Disadvantage

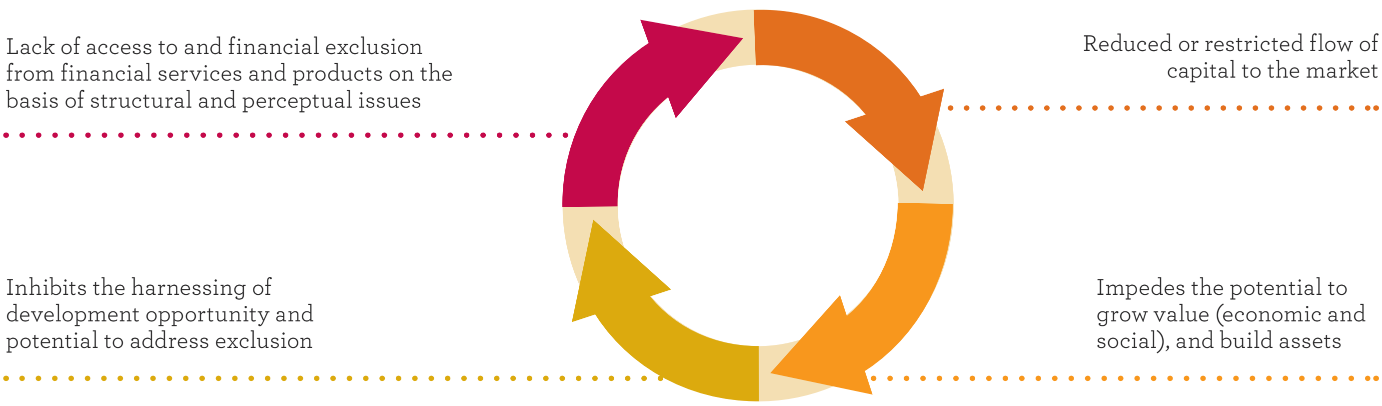
One of the major consequences of long-term exclusion from financial services and products centres on blockages to wealth-creation (ie. the establishment of an asset-base). It is increasingly recognised that addressing poverty (whether this is at the level of individuals, organisations or community) and responding to underserved markets requires not only a focus on welfare and income generation, but also a focus on wealth creation and asset development (see for example, Social Investment Taskforce UK, 2000). Financially excluded and underserved markets have fewer pathways out of dependence and poverty, and therefore they can become 'stuck' in a spiral of disadvantage, as depicted in Figure 2. Ultimately the aim of opening and structuring access to capital in underserved markets should be to break such cycles of disadvantage.

Explaining Underserved Markets

Why do Underserved Markets Exist?

A number of Australian authors have recently explored why certain groups are underserved and financially excluded (see references in Table 1 above). This paper does not seek to repeat this work, but rather, seeks to understand more comprehensively how these markets could be reached, and why intermediaries play an important role in this process. In order to do this, however, it is important to understand the broad landscape of why underserved markets exist. An analysis of the gaps that exist between consumers (on the demand-side) and capital markets or investors (on the supply-side) highlights some of the major reasons for and causes of exclusion.

Fig 2 *Financial exclusion can perpetuate cycles of disadvantage, making it difficult for underserved markets to harness development opportunities and pathways out of poverty*



Market Failure

A number of authors argue that underserved markets can be explained as a market failure (see for example, Daniels and Litvak, 1979; Levere, Schweke and Woo, 2006; Dymski, 2006; Thomas, 2008), identifying at least two key dimensions of this failure, as outlined below.

1. Information Failure

Information failure arises when information about an underserved market is costly to gather, and the returns a commercial operation can expect do not justify incurring these costs. For example, people living on lower incomes may have "shorter and more irregular credit histories, making an evaluation of their individual creditworthiness more difficult and costly" (Bernanke, 2006;p.3). It may take time and resources to assess the opportunities and risks of lending to people living on lower incomes, and the returns a commercial operation can expect from this market segment may not cover the costs involved.

As many assessment processes have been standardised (eg. loan assessments are computer-driven and have moved away from any elements of subjective or relational assessments) there is relatively little margin in mainstream financial institutions for taking risks on what Vandekerckhove and Leys (2007) refer to as the "Three C's" - Character, Capacity and Capital - which together make up the "constitutive pillars of trustworthiness in finance"(p.9).

In financing underserved markets these 'Three Cs' become important as many people, organisations and businesses in these markets may often fail standardised assessments, but may actually still be 'credit worthy' or able to service a loan. However, what is required is a detailed knowledge of the particular sector or underserved market, so that a financial institution can assess the viability of certain financial services. Further, engagement with these markets requires a commitment to structure financial services in ways that create opportunities and meet financial needs - and this comes at a cost, which needs to be born by someone - the financial institution or the customer, or a third party such as government or philanthropists.

The lack of knowledge about underserved markets leads to information asymmetries, which for some authors represent the most significant explanation of underserved markets:

"(The primary reason) that emerging domestic markets face capital constraints is information asymmetries—the lack of robust data on the markets. Without comprehensive, reliable demographic and financial information, financial decision makers, business leaders and public policy officials are unable to price risk and evaluate opportunities effectively"
(Yago, Zeidman, & Abuyuan, 2007, cited in Rubin, 2011;p.184).

2. Externality Failure

The provision of services to underserved markets often generates significant social impacts. However, in underserved markets the social returns from delivering financial services and products may exceed the potential financial returns that are available to investors (GHK, 2011). Mainstream financial institutions would not take social returns into consideration in making investment decisions, but in underserved markets, the provision of financial services needs to consider both social and financial returns if the value proposition of engaging in these markets is to be realised. This means that in engaging with underserved markets, financial institutions need to balance financial and social returns - which again can result in costs and assessments of inefficiencies by mainstream providers.

Further, mainstream financial institutions often generate profitability and sustainability either by building high volumes of transactions, or high value transactions. The latter is less likely in underserved markets, meaning that the sustainability of engaging with these markets needs to consider how to realise both:

- some level of scale or volume of transaction
- investment based on blended returns - that is, social returns in addition to financial returns.

If either of these tasks becomes difficult or costly, then profitability is compromised. The inherent difficulties of these strategies leads many to conclude that mainstream financial institutions will not voluntarily engage with underserved markets without some mandate from government or subsidisation from government or philanthropists:

"I think its fairly simple, I think its about profitability ... The private sector is looking to make a profit, and those who are underserved or financially excluded tend not to be profitable proposition for them ... I think there's a lot to be said for the banking sector being called upon to make contributions to the solution to financial exclusion, whether that be for individuals, not-for-profits or social enterprise. So I would want to see the private sector such as the banking industry being called upon to put their money where there mouth is basically"
(Intermediary).

More Than Market Failure?

The market failure explanation presents a seemingly simple range of 'solutions' to reaching underserved markets - that is:

- developing information and databases
- finding ways to price social returns so that they can be incorporated into cost structures of investing in underserved markets
- relying on government funding or philanthropy to fill in the gaps.

However some authors argue that the real picture of understanding why underserved markets exist is more complex than this. For example, Rubin proposes that there is a need to:

"push for a more sophisticated understanding of what underserved communities need—one that does not obscure or ignore the complexities of the problems ... "
(Rubin, 2010;p.183).

Others argue that the market failure model is too simplistic and one-dimensional, focussing only on opening access, leaving out a deeper understanding of how underserved communities are subjected to deeper, (and therefore harder to tackle), structural inequities. Thomas (2008; pp132-133) argues that:

"The market failure framework is primarily transaction based. The goal is ensuring individuals have the opportunity to obtain credit and, by default, that access is equitably distributed. ... Most of the literature has focussed on the (provision of credit) or transactional elements ... with less focus and understanding on the poverty alleviating, or transformational elements (needed to develop underserved markets) ... . The market failure framework may be missing an important element".

It is clear from interviews undertaken as part of this research that market failure alone cannot explain all the barriers that exist for underserved markets. At least two other key barriers exist that are not explained by market failure theories. These are outlined below.

1. Biases and Assumptions

On both demand and supply-sides there are biases and assumptions related to capital in underserved markets that go beyond information failure. On the demand-side, there are often negative perceptions about accessing finance and assumptions about the compatibility of debt finance and social impact. For example, non-profit organisations frequently insist that it is only an increase in grants and government funding that will build their viability, and there is a perception that debt or equity capital is not appropriate and indeed could be detrimental for this sector.

Equally, on the supply-side, there are assumptions made about the appropriateness of capital and/or the capacity of people, organisations or enterprises in underserved markets for holding and managing capital. For example, many financial institutions assume that non-profit organisations will not have the capacity to repay debt finance. A lack of understanding of the nature and financial realities of the non-profit sector can lead to discriminatory attitudes based only on perceived characteristics rather than any true capacity to service debt or generate financial returns.

People and organisations can also self-exclude either through lack of knowledge or negative perceptions about the relevance or appropriateness of financial services to their situations. This points to the need not only for service provision but also for market development.

2. Structural Inequities

Structural barriers also underpin the access certain people, groups and organisations have to financial services and products and can lead to the development or perpetuation of underserved markets. Structural barriers refer to the system of social, economic, institutional, political and cultural domains that together influence the creation, development and enduring continuation of underserved markets. These differ according to the nature of the underserved market and the context. They underpin why responses to underserved markets are more complex than merely opening access to finance or capital. Table 2 outlines some examples of structural barriers that can influence the effectiveness of responses to financial exclusion in each of the underserved markets identified in this report. The constellations listed here will not always exist for all underserved markets, but they highlight the complex factors that need to be considered in developing responses to financial exclusion.

These factors can be exacerbated and exaggerated by other wider structural issues and processes, such as:

- ***Broader economic, political and market changes,*** including: changing labour market structures, economic reforms that have particular impacts on certain people, regions or sectors; economic crises that impact on particular markets; shifts in policy and political ideology; technological changes that shift the nature of markets and change access for particular groups.
- ***Place-based structural inequities,*** with regional, remote, or places having been particularly effected by processes such as economic restructuring.
- ***Gender, race, ethnicity, class inequalities*** that mean particular groups are consistently over-represented in underserved markets.

This can impact both supply and demand-sides of the market, with the result being that in some areas or in some sectors, there are: less opportunities to engage with certain financial services and products; lower levels of awareness; and/or certain kinds of services can be crowded in (eg. predatory options for financially excluded individuals) whilst others are crowded out.

Addressing this requires a commitment to understanding what the structural barriers are in particular underserved markets, and in designing ways to address the barriers, and doing so in a way that actually reverses structural inequities rather than just putting a band-aid on their effects. Further, it is not these factors individually which create structural barriers, but their interconnections. This means that the nature of engaging in underserved markets becomes a matter of persistently working to address complex issues. Access is important. Capacity-building is important. But merely focussing on these without also working on cultural issues in organisations and sectors, without addressing place-based barriers or institutional dependencies, will not necessarily address exclusion.

This is no minor task, and requires not just financial investment, but a tenacity to highlight and then reverse often long-standing beliefs about markets that have taken on the mantel of 'truths'. For example, one interviewee highlighted the often invisible work of engaging with non-profit organisations seeking finance:

"On a really micro level, that work is all highly relational, it's definitely culture change stuff - we come up against cultural biases and barriers within the organisation's structure against the shift and change. Much of our work is about supporting the changemakers in the organisation themselves, helping them to build a case for that change, resourcing them to do that, giving them technical information and in the end providing them with the capital. So at a micro-level, it's highly relational, it's very much about a journey." (Intermediary).

Table 2 *Some of the factors that together can lead to structural barriers in underserved markets*

Underserved Market	Examples of Factors Which Together can Lead to Structural Barriers that can Influence Effectiveness of Responses
Financially excluded individuals and families	• Complex links between financial exclusion, poverty, social exclusion and indebtedness • Links between income and asset poverty • Persistent lack of political and commercial willingness to focus on prevention strategies and financial literacy levels.
Non-profit organisations	• Cultural conservatism in governance structures (risk aversion, reliance on traditional funding mechanisms) • Gaps in non-profit management knowledge and skills in relation to finance • Diverse norms of financial management, reporting and structuring of accounts that are focussed on funding rather than finance • Focus on income generation rather than asset building.
Social enterprises and social businesses	• Institutional delinking of commerce and social impact, with assumptions about their incompatibility (on supply and demand-sides) • Similar dependencies on certain forms of capital as non-profit organisations • Lack of wholistic accounting systems incorporating social impact costings into the market.
Small to medium-sized enterprises (SMEs)	• Cultural and economic constraints (on both supply and demand-sides) for growth capital (especially equity) • Place-based barriers in certain contexts (lack of critical mass of SMEs, lack of networks) • Gaps in knowledge, capability and cultural aversion to certain kinds of finance • Persistent lack of political and commercial will to address capital access of SMEs.

The Paradox of 'Underserved Markets'

Potentials for One-Dimensional Over-Servicing

Inherent in the notion that certain markets are underserved, lies a difficult and pervasive paradox. Often it is not the case that no market responses occur in these markets. Rather, responses tend towards being one-dimensional, meaning that such markets can actually be 'over-serviced' in certain ways. So, for example, in relation to financially excluded individuals, there has been a rapid growth of 'predatory' and fringe financial services within this market, leading to an over-servicing of this population at the same time as other financial services remain inaccessible or unavailable.

In relation to social enterprise and non-profit organisations, the paradox takes a different form. In these markets, there has been relatively little engagement with 'finance', with most organisations and enterprises seeking revenue from 'funding' and 'donations' rather than engaging with debt or equity finance options. The paradox in these markets then, is that organisations and enterprises are increasingly 'over-serviced' with one-dimensional options for growing or expanding their work, that is, increasing grant funding options. This in turn means that they either lack awareness of or access to other opportunities for growth and development, including debt and equity capital. This is highlighted in the following interview:

"I probably don't think of social enterprises as underserved as such – perhaps it's more about developing opportunities for a different type of servicing. ... I think social enterprises in many respects may have been over-served in terms of building up a reliance on grant funding, and that perhaps a better provision to them may take the form of creating access to a wider range of types of capital"
(Government).

The paradox is less distinct in the SME market, where the under-servicing relates to both debt and equity finance, but where (at least in Australia), equity as a source of capital is not well understood or accepted by business owners. This means that the market is developing responses primarily in relation to debt, which could lead to increasingly one-dimensional options for growth capital.

The pervasiveness of one-dimensional over-servicing extends not only to financial consequences for otherwise underserved markets, it also underpins and fosters perceptions of what is possible in these markets. Certain assumptions come to pervade thinking about potential responses in underserved markets. It is often assumed that non-profits, for example, are simply not investable or that their potential for growth is limited only to growing funding or donation revenue. One-dimensional over-servicing builds cultural norms that limit or even shut-down broader market responses.

Addressing the needs of underserved markets, therefore, requires an understanding of the limitations of one-dimensional responses, and an appreciation of the perils of one-dimensional over-servicing which potentially deepens the exclusion of these markets rather than opening up opportunities for financial inclusion.

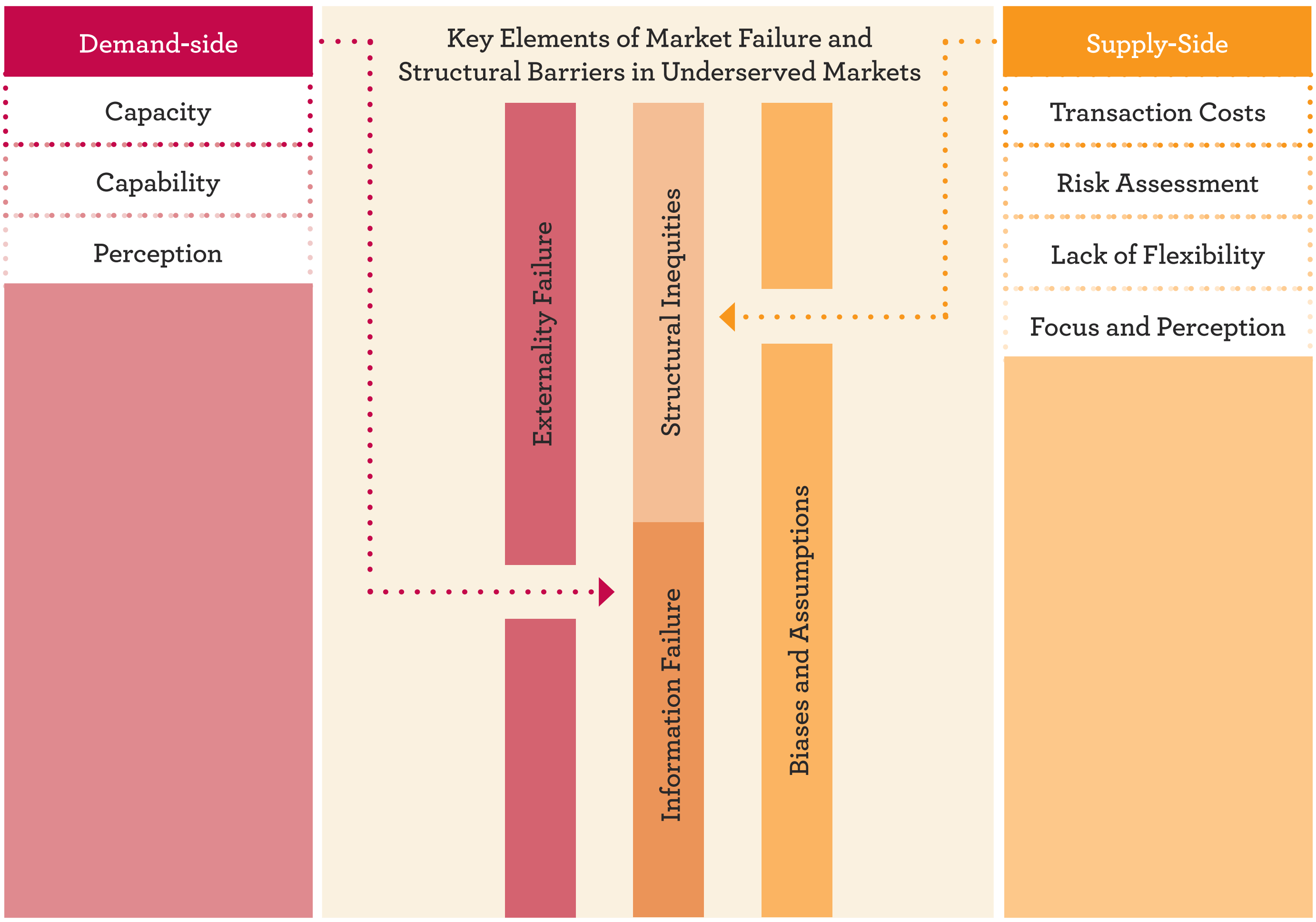
What Does this Mean for How we Finance and Invest in Underserved Markets?

It is clear from the above analysis that the provision of finance and investment into underserved markets is more complex than merely ensuring that access to capital is opened. To reiterate, the literature and research articulates a number of key reasons why underserved markets experience barriers in accessing and leveraging capital. These are summarised in Figure 3.

Given these various reasons why certain people, groups and organisations are excluded from mainstream financial markets, bridging the gap requires a focus not just on activating capital on the supply-side, but also on ensuring that there is a robust and engaged demand-side. To date, in Australia, the focus has been on opening opportunities on the supply-side, that is, in securing more capital for channeling into underserved markets (see for example, CDFI pilot, SEDIF). However, what is clear from older markets such as the UK, is that there is just as much, if not more need to focus in on the demand-side - as is indicated in this quote about lessons from financing the social enterprise sector in the UK:

"Pumping more finance into the sector is unlikely in itself to realise growth in the sector, without careful thought on how it is structured. A decade ago it was widely expected that greater supply of capital would increase demand from strong ventures. Instead, despite the relative growth of social finance, many social investors struggle to find investible ventures. ... The problem seems not to be one of poor supply of capital but a lack of demand from viable ventures ready to receive such investment"
(Shanmugalingam et al, 2011;p.32).

Fig 3 *Key reasons and causes for financial exclusion resulting in underserved markets as cited in research and literature*



Research about underserved markets indicates the need for intense engagement on the demand-side to ensure that people, organisations and enterprises:

1. are aware of the range of capital sources available
2. have an understanding and the technical capacity to apply a range of capital types
3. have a clear understanding of how different financial products and services could improve their financial position and performance, and a willingness to engage with such services for this purpose
4. have the cultural orientation to explore and engage a range of types of capital (beyond grant funding for example)
5. have developed the capability[1] and financial readiness to manage and navigate different financial products and services to ensure that improvements lead to better financial outcomes and impacts.

All of these factors are key to developing the pipeline of investible and investment-ready entities to ensure that finance can flow effectively into underserved markets. As the quote above indicates, there is little point in turning on the tap to increase the flow of capital on the supply-side, without a recognition of and a commitment to the work needed on the demand-side to prime underserved markets and ensure that the capital actually creates social and economic impacts rather than merely flowing around or straight back out of these markets.

The fundamental question then, is ***how*** do we provide finance and investment into these markets in ways that incorporate both access and have the potential to transform these markets.

In order to understand ***how***, we need to examine the role of intermediaries in bridging demand and supply-sides.

What is Financial Intermediation and What is a Financial Intermediary?

Intermediation is not only a function that relates to underserved markets, but has been an important concept in the development of mainstream financial markets. Theories of how financial markets function have long explored the mechanisms needed to create efficient and effective markets, and many have argued that financial intermediaries play a crucial role in this process both from a micro-perspective (creating more efficient relationships between borrowers and lenders) and from a macro-perspective (enabling more effective economic development) (see for example, Bhattacharya and Thakor, 1993; Allen and Santomero, 1997; Scholtens and van Wensveen, 2000; Peachey and Roe, 2004; Beck, Levine and Loayza, 2000).

In broad terms a financial intermediary is defined as:

any institution that facilitates the channeling of capital between the supply and demand-sides of a capital market.

Intermediaries have the capacity to receive capital (through for example, deposits or investments), pool this capital, and then channel it out in the form of loans or investments to 'investees'.

[1] This report draws a distinction between capacity and capability. Capacity refers to ability of a person, organisation or enterprise to effectively and responsibly utilise particular financial services (so, for example, a social enterprise having sufficient cash-flow to repay a loan). Capability refers to the skills and knowledge needed to manage financial services (so, for example, an organisations skill at managing both restricted and unrestricted income and ensuring that they have sufficient savings to cover reductions in cash-flow).

An intermediary in any market (mainstream or underserved) plays various roles that make the process of linking investors and investees easier and more efficient by being able to:

- pool and mobilise capital
- structure it
- offer understandable products
- channel capital appropriately
- facilitate transactions
- evaluate investments
- manage risk
- reduce transaction costs
- broker the connection between investors and investees.

In mainstream financial markets the roles of 'intermediaries' are taken for granted, and there is not much public recognition of the term 'intermediary' - with most merely being referred to as 'financial institutions'.

Financial institutions that play intermediary roles in ***mainstream*** capital markets include:

- ***Deposit-taking institutions*** such as Banks, Building Societies and Credit Unions.
- ***Non-bank financial institutions*** such as finance companies, insurance companies.
- ***Investment funds*** (such as managed investment funds, superannuation funds) and ***other investment advisors and brokerage structures*** (such as stock exchanges and brokerage companies).

In mainstream financial markets such 'institutions' have built a system of market-based compensation into the financial transactions that they intermediate, through fees and interest payments set at rates that are recognised and accepted by customers and investors alike. Further, the scale of many mainstream intermediaries means that they are able to significantly reduce transaction costs and increase efficiencies.

Researching Financial Intermediaries and Underserved Markets

There has been a great deal of exploration of the relationship between the role of mainstream intermediaries such as those listed above in macro-economic development (see for example the broad literature examining the important economic role of financial intermediaries in so-called 'developing' countries - starting with Goldsmith, 1969; McKinnon, 1973; Rajan and Zingales, 1998; Peachey and Roe, 2004) . Unfortunately there has not, however, been such significant research and theorisation about the role of intermediary institutions in developing underserved markets in countries such as Australia, the United States, Canada or Europe - though there is some literature about the role and purpose of intermediaries such as CDFIs in these contexts (see for example, GHK, 2010; Rubin, 2010; Shanmugalingam et al, 2011).

This absence of research and theory is disturbing in so far as it would seem relatively important to understand how intermediation could play as important a role in addressing financial exclusion as it clearly does in supporting and developing mainstream markets. This is particularly the case given that extensive research internationally argues that:

"simply applying existing finance models to social ... projects has had limited impact in terms of growing both the supply and demand-side markets. Conventional finance institutions appear ill-equipped to act as the catalytic intermediaries in this space and the power relationships inherent in this monological approach create disincentives on the supplyside to engage"
(Nicholls and Pharoah, 2008;p.40).

Finance and Investment in Underserved Markets

What Specialist Intermediation is Needed?

What is clear from the above analysis is that engaging with underserved markets is not simple - it is not just about 'add capital and stir'. This means it is about more than 'transactions' and ensuring that there is access to financial services and products. In order to engage with underserved markets there is also need for 'transformational elements' (Thomas, 2008) - that is, the processes, activities and methods that are needed to achieve real impact, and to ensure that access to financial services and products actually does lead to opportunities and asset development in underserved markets, rather than just creating debt. Figure 4 illustrates how both these elements are important in reaching and creating impact in underserved markets - the metaphor being that it is not enough merely to turn the capital tap on, there is a need to ensure that the capital soaks in and actually grows wealth and opportunities.

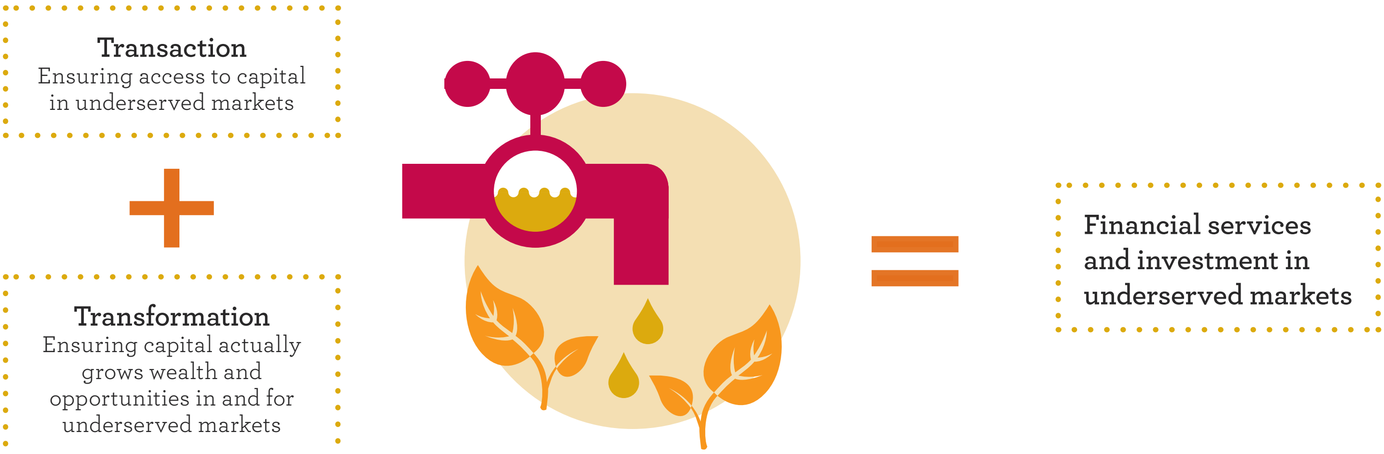
Exploring these 'transformational elements' is important but difficult, as there is relatively little research or literature that unpacks these elements. However, if we can articulate what these transformational tasks are and their impact in underserved markets, then we can begin to understand why it is not enough to merely 'force' mainstream financial institutions into underserved markets. It is not the case that "more lending equals better outcomes" in underserved markets (Bernanke, 2006;p.4). It is also necessary to be able to "differentiate 'good' from 'bad' lending" (Bernanke, 2006) and thus be able to demonstrate that access to capital actually leads to broader outcomes and greater impact in underserved markets over time. This in turn helps to distinguish 'predatory' and 'subprime' lending from what could be termed 'developmental' finance.

To begin this articulation, it is necessary to explore the range of intermediation roles needed to address market failure and overcome structural barriers that limit access to and use of financial services and investment in underserved markets.

Transactional Elements

Engaging in underserved markets requires a particular approach to finance and investment, which ensures that these markets gain access to capital. As examined above, the market failure analysis proposes two key reasons that access is restricted in underserved markets - information asymmetries and externality failures. From a transactional perspective, overcoming these barriers requires the application of banking and finance skills to underserved markets, which are seen by mainstream financial institutions as unprofitable or costly to engage with. For those who see transactional elements as the key to unlocking capital for underserved markets the hurdles are

Fig 4 *Investing in underserved markets is about more than access*



primarily about information, awareness, appropriate use of financial instruments and application of banking technology.

If we apply this analysis to the Australian context, the information asymmetries that intermediaries need to overcome in order to reach underserved markets include the following.

Underserved markets are 'thin' markets:

- Underserved markets are not 'crowded' markets, so there's relatively little experience to cite or draw on (comparatively), and there's still a need for 'first movers' to pioneer pathways into these markets (Economic References Committee, 2011).
- The volume of investment transactions are relatively low and returns history is relatively short in the Australian market, so there's little information about returns/impact available to prospective investors.

Underserved markets include entities that have non-traditional business models or financial structures, making it more difficult for investors to assess risks:

- Non-profit organisations and social enterprises often include public sector funding or philanthropic grants in their revenue streams.
- Non-profit organisations and social enterprises often have a blended value focus (looking to generate both financial/commercial value and social value).
- Non-profit organisations can have a different approach to profit (referring to surplus, and applying this differently to private companies).
- Non-profit organisations often have more complex financial records - and financial assessments need to be able to distinguish restricted and unrestricted funds.

Underserved markets are relatively 'new' markets:

- There is relatively little data about the nature and viability of non-profit organisations from a financial perspective.
- There is relatively little understanding of the cost/benefit and risk profiles of adding social benefit to an investment proposition.
- There is relatively little understanding of non-welfare responses to financial exclusion or underserved markets.

The lack of information about underserved markets leads to problems in understanding risk, potential returns and inefficiencies, as Yago et al (2007;p.3) highlight:

"The information gap, perhaps the most important factor, leads to an inefficient deployment of capital to these (markets), thereby exacerbating other factors and creating a larger capital gap"
(Yago et al, 2007;p3).

This in turn leads to a reduced flow of capital into these markets - as Harji and Hebb (2010;p.2) suggest:

"Social investors are not able to calibrate risk and opportunity adequately, contributing to the paucity in the range of financial instruments and intentional flow of finance to this sector".

To address these barriers, specialist intermediaries focus on bridging the information gap by developing relationships, building understandings and collating data about the needs of underserved markets. They then apply this information directly to product development so that financial services focussed on underserved markets can meet needs, generate impacts and demonstrate commercial soundness. Over time this reduces risk, promotes confidence, and ensures impact. This in turn demonstrates that these markets can be reached, and that there is a validity in engaging with them. A number of the interviewees highlight the importance of this:

"we are not experts in microfinance or community investing by any measure so we actually depend on (intermediaries) to provide us with that information because we trust their expertise in the area. ... Without that information we would almost write it off because we don't know anything about (these sectors) ... they know the sector(s) much more than we do, they know the sectors needs ... And ... there's a role for them to be able to aggregate all these potential community finance deals and bring them as a package to the market. So instead of us going to a specific social enterprise and investing in them, (intermediaries) are obviously in the best position to pull these together and ... diversify the risk and bring them to the market. This role ... is I think what's going to reduce the risk ... going forward"
(Investor).

"It's a question of expertise in assessing loan applicants and potential investee projects - there's a lot of work to be done in assessing whether an organisation is at a place where it has the capacity planning practice to specialise in or want to do more of. We want to get people who are experts in those kind of things to do that work. There's also (the work of) sourcing the projects- they don't all fall into your lap ... it's good to have specialist organisations who are working in the community sector who see opportunities emerge and make those known to potential investors. There's also the spreading of risk - I mean really we'd much rather that our clients were investors across ten projects rather than just one, given the potential for failure in any organisation and the desire to diversify. I think all of those things are important"
(Financial advisor/planner).

"I think that risk is misconceived often when it comes to, well take the example of underserved individuals and people on low incomes, I think there's a misconception about the risk and that's been bought out by fairly low default rates in some of the pilot programmes. I think the same with the community sector, (our) experience has been that not-for-profits are a very good credit risk but that's not understood within the mainstream market, so there are those misconceptions of risk because of information asymmetries"
(Intermediary).

From a transactional perspective, the solutions lie in applying market principles more rigorously to open underserved markets - as outlined below:

"In April 2006, Federal Reserve Chairman Ben S. Bernanke recognized the importance of community economic development data. "By making companies, entrepreneurs, and investors aware of the new opportunities," he said, "and by promoting competition in underserved areas, such information helps put market forces in the service of community development." A well-constructed data consortium could help eliminate information barriers and unleash the dynamism of the financial markets through knowledge building and product development. Ultimately, both the emerging domestic markets and the national economy would benefit"
(Yago et al, 2007;p.iv).

However, in response to this perspective, others argue that:

"By diagnosing the problem as primarily one of information failure, emerging domestic markets' proponents put forth solutions—more data on the markets—that neglect ... additional barriers to investment"
(Rubin, 2010;p.188).

Authors such as Rubin argue the danger of focussing only on the transactional elements of engaging with underserved markets is that it assumes that market failure can be solved purely by more effectively applying market principles. From Rubin's perspective, in addition to addressing the fundamental question of access, it is necessary for intermediaries to work on the whole range of complex reasons why underserved markets are excluded from financial products and services. And this goes beyond seeing the issue only from a financial perspective, or only as focussed on 'transactional' processes.

Transformation: Beyond Only Addressing Lack of Access

The role of intermediaries is not just to address the fact that many underserved markets are unable to access financial services and products. Intermediation requires a deeper understanding of what the gaps are for particular markets between demand and supply-sides. Intermediation in underserved markets is about bridging the gaps and ensuring that access leads to impact in those markets. Ultimately, intermediaries are focussed on ensuring that access to finance in underserved markets leads to impacts such as inclusion, wealth creation and pathways out of poverty, and longer term viability and sustainability of businesses and organisations. Such a vision requires skills beyond financial transactions. This is perhaps why many specialist intermediaries focused on financing underserved markets in the UK and the US are referred to as 'Community Development Finance Institutions' (CDFIs) as a recognition that the work involved requires an understanding of community development methodologies in addition to the application of finance and investment tools. A focus on transformation may include addressing the following issues in the process of engaging with underserved markets.

Tailoring

It may be necessary to tailor financial products in ways that take into account the appropriateness, affordability and potential impact of the offerings. So, for example, an intermediary who focusses a loan offer to social enterprises but does not consider a risk assessment that is different to mainstream lenders (eg. does not consider that many social enterprises may not have collateral to offer as security); or a financier who merely offers the same terms or product structures as mainstream financial institutions, may not actually be bridging the gap between supply and demand-sides any more than an intermediary not focussed on this underserved market. Further, consideration of impact alongside financial returns may mean that financial assessment and management processes may need to be tailored in ways that reflect rigour on both these dimensions. So, for example, it may not be appropriate to merely transfer risk from a particular entity such as a non-profit organisation to another party (such as the directors of the non-profit) if this ultimately does not contribute to the generation of impact that is sought in the underserved market.

Market Creation and Development

In underserved markets it is highly unlikely that financial intermediaries are going to walk in and find a ready-made, commercially viable market waiting for their services - otherwise mainstream financial services would already be servicing these markets. The complex barriers that develop in underserved markets lead to financial exclusion over time, and equally, to begin to address this exclusion requires not only a deep understanding of the market and the barriers, but also a commitment to helping to create a market where there has not been one previously. Market creation involves work on both demand and supply-sides. On the demand-side there is often a need for awareness-raising, capacity-building and other technical assistance. It can take time and expertise to work with underserved markets to ensure that access to capital actually generates impact.

Stretched Transaction Times

Transformational activities may stretch out timeframes within financial deal-making, as is highlighted by the following interviewee:

"If you put it on a graph, you get fairly low level activity at the front-end, that's not so time intensive - it might be an hour long discussion on the phone and a bit of time spent in the application, but that's really just simple, it just requires an organisation to fill out a form and send some financials. And then you get this steep curve upwards from there as you engage in the due diligence process which could take anywhere from a month, to three, six months depending on the organisation. We could turn around a due diligence exercise probably within a week, but that's not what takes the time - it's the to-ing and fro-ing and decision-making on their side, and the barriers along the way and the stop, start of that. If you put it all together in a concentrated sort of fashion it might take anywhere between a month and six weeks to do a deal. If that's all you were working on. That gets spread out anywhere between three months and a year in reality. It's always more complex than what you see (as the) 'deal'. Often organisations have so much to sort through - it can take months to work through and sort through. There's often a lot to untangle"
(Intermediary).

Capacity, Capability and Technical Assistance

Internationally these transformative elements are increasingly seen as a key part of the reason why specialis financial intermediaries have been successful in reaching and generating impact in underserved markets:

"... CDFIs are institutions that have learned to effectively manage the "risk" that discourages conventional financial institutions from serving low- and moderate-income individuals and communities. ... CDFIs have succeeded in lending to and investing in individuals and communities not served by conventional financial institutions, while maintaining loan performance standards generally equivalent to those of the conventional financial sector. However, ... the costs of serving these individuals and communities is somewhat higher because good performance is, in part, due to the additional technical and training services provided by most CDFIs"
(Swack et al, 2012;p.17).

Supporting 'Paradigm Shifts' and Cultural Change

In underserved markets breaking what has become the 'status quo' culturally, can require paradigmatic shifts - which can take time and a great deal of risk for the 'first-movers' who choose to work in ways that are unfamiliar to most in a sector or community:

"Many (NFPs) have operated on a completely different mentality, they haven't even considered going to get a loan because they tend to see themselves as almost hand to mouth type operations, so they get their government grants, they're happy to go to philanthropy and get grants, they'll raise money from the community but not from a debt perspective. And they really try to cobble together enough money to do the sorts of things which they want to do. So the notion of going into debt to expand what you're doing, or do something erently, has not been the normal way in which they've thought about their businesses" (Government).

"There's a big apprehension in Australian non-profits and social enterprise about debt - and there's a big apprehension about equity in terms of someone taking over control of your company. I think it's an unfamiliar model for the vast majority of social enterprises in Australia. People are used to asking for grant funding and getting their heads around going into debt, there's a big cultural change process - not just for CEOs but particularly for their boards"
(Intermediary).

Transforming the Supply of Capital

While much of the attention in transformation is focussed on the demand-side, this is not to imply that investment and the supply of capital for underserved markets is immune from transformation. On the supply-side, there is also a need for intermediation to 'educate' investors about the value of investing in underserved markets, and to challenge and develop risk-return profiles that make such investments viable through the brokerage of an intermediary. This needs to happen not only through the development of investment products and marketing, but also through intermediation at various investment touch-points, ensuring that the flow of capital comes from as diverse and scalable sources as possible. Therefore, if investment is flowing only from government or from philanthropic sources, then efforts need to be made to explore and open up other opportunities, pointing to the potential need for greater focus on supply-side intermediation for this purpose.

Transaction and Transformation Work Together

Financing these markets, then, requires:

- ***building*** capacities and capabilities
- ***bridging*** gaps between these capacities and appropriate financial services and products
- ***brokering*** between different stakeholders across the supply and demand continuum to ensure that finance can flow into these markets and that as a result, social and economic impacts can be generated.

Intermediation in underserved markets is certainly about opening access to capital (transaction). But in the process it is also about much more than this - it is about changing perpectives, practices, behaviours and visions. And this is about much more fundamental transformations. The following interviewee articulates the various levels of change that happen when a non-profit organisation begins the process of exploring debt finance and investment as a mechanism to support their wider missions:

"(This work is) twofold I guess. On one level it is just about access - it's about (organisations) getting capital to do a job and (for them), in the end, (when they approach us it means that they) can't get that money anywhere else. And that's really been reinforced by some of the changes at a government level across the states and even federally as they move towards more austere policies around funding, I think that we'll see this creeping orientation towards finance as a source of funding, because there's nothing else available. ... But ... on a deeper level than that too, there's some sort of behavioural change going on - around being more business-like, thinking about how to achieve the outcomes of a non-profit or social enterprise using the mechanisms of business in a particular way, not by becoming a business, but by using those tools. I would reflect that takes a real shift because many of the people who traditionally run these organisations are not entrepreneurs, they are social workers or psychologists or other helping professionals - so, on a behavioural level that shift is not insignificant at all - you're asking the organisation to balance its practice with business rather than focus only on its practice and expect that someone else is going to fund that endlessly" (Intermediary).

A Process and Ecology of Intermediation in Underserved Markets

Intermediation for and in underserved markets is not a singular activity, nor a one time event. Neither is it focussed only on one sector or on either the supply-side or the demand-side. It bridges demand and supplysides, and in doing so there are numbers of touch-points and focussed intermediation roles across this continuum which need to be unpacked if we are to fully understand the role of intermediaries in underserved markets.

Figure 5 outlines the various types of intermediation that are needed across both demand and supply-sides to ensure that underserved markets have access to, and are able to effectively engage with financial services - in other words, intermediation that incorporates both transactional and transformational elements.

From this diagram it is clear that what is needed to bridge the gap between demand and supply-sides extends beyond just the provision of financial products and services. For this reason it is not just specialist finance institutions that are needed to reach underserved markets, but a range of intermediaries that fulfill a number of key intermediary roles, including a focus on skills, investment-readiness, market building, advocacy and research - for, as Shanmugalingam et al (2011;p.7) also highlight:

"Particularly at earlier stages of development, finance is not always the most important. Equally vital are access to skills, advice in shaping business models, and networks and relationships".

Fig 5 *Mapping the supply and demand-side intermediary roles*

Demand-side			Supply-Side	
Development and Investment-Readiness Intermediation	**Social Finance Intermediation**		**Social Investment Intermediation**	**Investor Market Intermediation**
Design and Development, Business Model and Planning Support, Designing Impact and Enterprise Responses	Capacity and Investment-Readiness Assessment and Appraisal	Developmental Intermediation and Brokerage	Investment Product Design and Development	Impact Investment Wholesalers
Capability Support and Training, Confidence and Network Development	Financial Product Design and Development	Market Building and Development	Investment Product Structuring and Marketing	Impact Investment Advisors
Capacity Development (eg. assistance with economies of scale; procurement assistance; business development)	Finance Structuring	Advocacy and Research	Capital Supply Development	Impact Investment Market Researchers
Impact and Outcome Tracking Support and Communications	Financial Monitoring	Partnership Development	Investment Management	
			Investor Information Development and Reporting	

Thus the intermediation includes specialist intermediary institutions such as Community Development Finance Institutions (CDFIs), but also includes other intermediary institutions vital to bridging the gaps between demand for and supply of capital in underserved markets. Some intermediaries focus specifically on some areas of this continuum, while others focus on elements across the whole continuum.

Further, in the continuum we distinguish between 'social finance' intermediaries (who are demand-facing and focus on how the capital is structured and channeled into underserved markets in ways that are commercially sound and meet needs/deliver impacts), and 'social investment' intermediaries (who are supply-facing and focus on the structures and processes around how the capital is pooled from investors, the structuring of products that will attract a range of investors, and that will ensure both financial and social returns to investors). These terms are often used interchangeably, however we argue that they actually represent quite different intermediation roles and that this distinction should be recognised by those interested in reaching underserved markets.

The key is to approach this continuum as representing the ecology of intermediation processes that are needed to respond effectively to the exclusion of underserved markets. The application of the continuum will look different in different underserved markets, but the intention of looking across the demand and supply-sides to address both financial and non-financial elements of exclusion is critical across all markets.

The Need for Programmatic and Institutional Responses Across the Continuum

The development of responses to underserved markets in Australia in recent years have led to three key intermediation sites (see also Burkett et al, 2011), as depicted in Figure 6.

In this paper, the focus rests primarily on the middle response - that is, an institutional response focussed on developing independent specialist intermediaries. This is not to say that all intermediation focussed on underserved markets requires an institutional response - indeed programatic responses are often needed alongside institutional responses. However, in responding to ongoing or long-standing market and/or government failure, institutional responses can ensure greater longevity, scale, scope and depth

Fig 6 *Three key sites in which intermediary roles are developing in Australia*

Programmatic Response 1:
Within mainstream financial institutions

Programs located within mainstream financial institutions as 'specialist' units to engage directly with underserved markets either independently or in partnership with other organisations. The programs are often undertaken as community services or under the banner of corporate social responsibility rather than existing as profitable business units. Australian example: NAB's microenterprise loan fund

Institutional Response:
Independent specialist intermediaries

Independent specialist intermediaries that are developed to engage with and service one or more underserved markets with the goal of bridging demand and supply in ways that grow opportunity in the underserved market. These intermediaries may undertake one or more intermediary roles. Australian examples: Foresters Community Finance; Social Traders

Programmatic Response 2:
Within social service/charitable organisations

Programs developed in social service organisation to respond to gaps between demand and supply-side. These are often undertaken in partnership with financial institutions, with the social service organisation providing the 'front-end' to the service - undertaking assessments on the demand-side, and then brokering access to capital (usually with below-market terms). Australian example: NILS programs administered by non-profit organisations than can be shorter or more focussed programs. Institutions with a clear mission to reach out to underserved markets, and to create a bridge between these markets and sources of capital have, according to overseas experience, clear impacts.

Further, and most importantly, finance and investment is highly regulated in Australia - and therefore an engagement with underserved markets using finance and investment strategies is also subject to regulatory and legislative scrutiny. For this reason any structured intervention into underserved markets needs an institutional base that can comply with all the necessary regulatory regimes, including financial services and credit licenses.

Conclusion

Addressing the financial needs of underserved markets is not merely a matter of opening access to capital. The fact that underserved markets exist points both to market failure, but more than this, to structural inequities.

Specialist financial intermediaries are needed to bridge the gaps between the demand and supply-sides of underserved markets, and to ensure that opening access to capital actually serves the needs of these markets and ultimately leads to positive social impacts in these markets.

This part of the report has examined the nature of underserved markets in Australia, and has provided an overview of the various roles that specialist financial intermediaries (focused both on transactional and transformational elements) play in: building capacities; bridging gaps between capacities and financial services and products; and brokering between different stakeholders across both demand and supply-sides of the market.

This part has deliberately presented a macro view of such intermediaries because of the diverse nature of underserved markets in Australia (covering individuals, non-profit organisations, social enterprises and small businesses).

In part two of this report the broad concepts explored in this first part are applied to a particular underserved market in Australia, that of social enterprise. This second part brings to life the overview of roles of specialist intermediaries and explores in greater depth the processes and structures of reaching an underserved market.

References for both Parts One and Two are included at the conclusion of the Report.

Part Two:

Intermediation in Action - Financing Social Enterprise

Introduction

This is the second part of a two part report examining the role of specialist financial intermediaries in reaching underserved markets in Australia. This part examines the roles and challenges of intermediaries in one particular underserved market in Australia - that of social enterprise. This enables some more detailed assessment of how intermediaries work, and the multifactoral processes involved in financing underserved markets. Some of the identified roles of intermediaries could equally apply to other underserved markets, though of course the details and practice may be different.

Snapshot of Social Enterprise in Australia

Social enterprises are organisations that:

1. Are led by an economic, social, cultural, or environmental mission consistent with a public or community benefit.
2. Trade to fulfil their mission.
3. Derive a substantial portion of their income from trade.
4. Reinvest the majority of their profit/surplus in the fulfilment of their mission (Barraket et al, 2010; Social Traders, www.socialtraders.com.au).

According to the FASES research (Barraket et al, 2010), there are up to 20 000 Australian social enterprises; and the sector is mature and sustainable (amongst the 365 respondents to the FASES national survey, 73% had been operational for at least five years, and 62% were at least 10 years old). The research also found that social enterprises operate in every industry of the Australian economy.

Financing Social Enterprise

The Needs and Realities

Research in Australia and internationally suggests that social enterprises face significant barriers in accessing capital to start, develop, grow and scale (see for example, Productivity Commission, 2010; Burkett, 2010; Burkett and Drew, 2008; Lyons, 2007; DEEWR, 2010; Conaty and McGeehan, 2001; Brown and Murphy, 2003; Mitchell et al, 2008; Carrington, 2004). The research points particularly to the barriers social enterprises face in accessing debt capital (for asset development, working capital, and bridging finance) and equity capital (for growth and innovation). The key barriers relate to gaps in both demand and supply-sides of the market, as summarised in Figure 7.

Fig 7 *Key demand and supply-side gaps in financing social enterprise in Australia*

Social Enterprise Finance
Key Demand-side Gaps

» ***Capacity and Investablity***
Financial ability of a social enterprise to secure and service debt and/or provide returns to investors

» ***Capability and Investment-readiness***
Skills and knowledge level of a social enterprise to plan for and manage finance and investment

» ***Cultural Readiness***
Governance and management culture and confidence to be able to engage with finance, and manage the risks and potential benefits associated with this (from financial and impact perspectives)

» ***Form and Structure***
Legal structures limitng particular forms of investment - eg equity investments

Social Enterprise Finance
Key Supply-side Gaps

» ***Availablity and Access***
Standardisation of assessment and reduced availability of business lending flows on to social enterprise particularly given exaccerbated information gaps

» ***Costs***
Increased transaction costs of assessing and understanding social enterprises

» ***Information and Understanding***
Information gaps about social enterprise, and assumptions about their blending of impact and business which undermine willingness to lend or invest

What Role Does Finance and Capital Play in Social Enterprises?

Over recent years social enterprise development has attracted attention from both funders and financiers, and Australian social enterprises have accessed grants, philanthropic capital, crowd-funding and finance in order to develop and grow their businesses. Research argues that while each of these forms of capital may have important roles to play in social enterprises, attention to 'right capital' for 'right purpose' is important:

"careful consideration (should) be given to how each of the forms of capital can be directed at 'right purpose', that is, how capital can be structured such that it supports the enterprise to develop solid foundations for viability and sustainability from early on in its lifecycle"
(Burkett, 2010;p.50).

Table 3 outlines the roles, advantages and disadvantages of three major forms of capital in social enterprise.

It should also be recognised that currently grant capital still dominates the social enterprise sector in Australia. As a result of the SEDIF initiative there are a growing number of debt capital options for social enterprise, however equity capital is still quite limited in this sector. This is partly because of a lack of awareness and demand, but also because many social enterprise are not structured to be able to attract equity - as one interviewee highlighted:

"The vast majority of social enterprise structures make it difficult to access equity capital because of the nature of their legal structures and the lack of exit strategies. Until there is a legal structure that can allow social enterprises to access equity capital and also then be still able to attract philanthropic capital, and ways to exit, then we're not going to see the development of an equity market in the social enterprise sector"
(Intermediary).

For Social Enterprises, Finance is a Means to an End, Not an End in Itself

As the fields of social finance and social investment are growing in Australia, it is necessary to remind ourselves frequently about the reasons why these are important areas of focus and catalytic funding. Social investment is not an end in itself. Similarly there is little point in developing a social finance market just for the sake of having capital available should social enterprises and other underserved markets need it. Social finance and social investment are means to an end - they represent one dimension of what is needed if we are to build a thriving and sustainable social enterprise sector.

If social enterprises are to develop into viable and sustainable businesses that have social impact at their core, then they need access to a wider range of capital than just philanthropy or government funding. Social enterprises need to be able to secure the 'right' capital for different parts of their business. Otherwise they will not be able to hold onto their dual foci - ***viable businesses*** focussed on ***social impact***. Debt and equity capital can be important parts of this picture, helping social enterprises to build their trading revenue and an asset base that can underpin their financial sustainability but also, perhaps more importantly, to ensure that they are able to achieve the outcomes and impacts that lie at the heart of their ventures. This does not mean that debt and equity are appropriate forms of capital for all social enterprises. However, where they are appropriate, these forms of capital can, alongside grants and philanthropic capital, open important opportunities for social enterprises.

Table 3 *Features of the major types of capital as they are applied in social enterprise, Source: Burkett, 2010*

	Grant Capital	Debt Capital	Equity Capital
Advantages	• Non-repayable • Virtually 'risk-free' (although the move to outcome funding is changing this) • 'Known' form of capital – particularly to those social enterprises who stem from community or welfare sector.	• Flexibility in use - Uses of capital can be much more determined by the enterprise rather than by an external body such as a funder • Can be long-term • Can assist in building financial discipline into the enterprise and strengthening management and planning.	• Provision of larger amounts of capital for growth • Returns are based on income • Can be long-term • Can assist in building financial discipline into the enterprise and strengthening management and planning.
Disadvantages	• Often restricted to particular projects or outcomes which may represent a distraction for the enterprise • Often do not contribute to the development or sustainability of the enterprise itself – solely focused on funding program outcomes • Often focused on short-term projects rather than long-term sustainability of the enterprise • Often relatively small and targeted so cannot help to consolidate enterprise development or growth • Time consuming and bureaucratic application processes with long lead times.	• Is repayable under the particular conditions set out in the loan contracts – so requires careful analysis, as these conditions are not always flexible enough to assist enterprises • Requires that the enterprise maintains adequate levels of income over a long period of time • Generally requires some kind of loan security • Often require risk assessments which can be difficult for social enterprises to meet.	• Can be difficult to structure 'pure' equity arrangement because this requires that enterprises have particular legal structures • If investors condition their investment with some form of 'control' in relation to the management or governance of the enterprise this can create concern about takeover or mission-shifts • May be significant costs involved in offering stages and in monitoring for investors.
Best Uses	• Support, participation and impact costs • Infrastructure and development costs • Specific projects • Initial program development.	• Purchase of assets and equipment to develop the enterprise • Use of short-term working capital to smooth cash flow lumpiness • Bridging finance.	• For social enterprises that have good scale and income potential but who may lack the capital to develop these • Soft and untied development costs…eg. staff development – can't be financed through debt capital.
Pitfalls for Social Enterprise	• Can lead to some level of dependency and constrain development of 'enterprise' or 'business' focus • Can detract from development of financial rigour and discipline in the enterprise.	• Not generally suitable for growth stages • Conditions must be carefully assessed to ensure that debt conditions do not reduce focus on impact, and builds viability and sustainability rather than liability.	• Requires careful thought and planning to ensure that the risks to the enterprise are minimised and that appropriate investors will be attracted.

Understanding this is key to maintaining a focus on impact in relation to social finance and social investment. Capital is the ***mechanism*** that specialist financial intermediaries utilise to effect change - but without a purpose for doing so their activities can quickly become merely transactional. The real game is not the mechanism but the ***purpose*** for using this mechanism - that is, to contribute to realising a viable and sustainable social enterprise sector in Australia (as depicted in Figure 8). As one interviewee argued:

"The value of this work is not in the dollar value of the loan. The value is in what the loan can achieve, what's the money going to do to make a difference?"
(Intermediary).

For intermediaries then, developing a purpose and vision that extend beyond provision of finance is critical, as is the development of an evaluation and impact framework that tracks progress towards the achievement of the purpose and vision. As one interviewee suggested:

"To me at the heart of it too, there's not enough emphasis on this kind of internal, well understood mission ... it has to be first and foremost about achieving your mission before profitability, before anything else. I don't think we've got enough clarity around that ... Of course you need the financial expertise so that it is more than a community sector organisation programme, (a CDFI) is an institution with the expertise to deliver, but ... that core mission is crucial and (we need) that understanding that if the mission's not being fulfilled you may as well pack up and go home there's no point in existing - it doesn't matter how profitable you are ... ".
(Intermediary).

The Bigger Picture of Social Enterprise Intermediaries

In the context of social enterprises, the concept of 'intermediaries' has a broader definition than merely referring to financial services. The Australian Government's Economics References Committee (2011;p.xv) defines intermediaries as any:

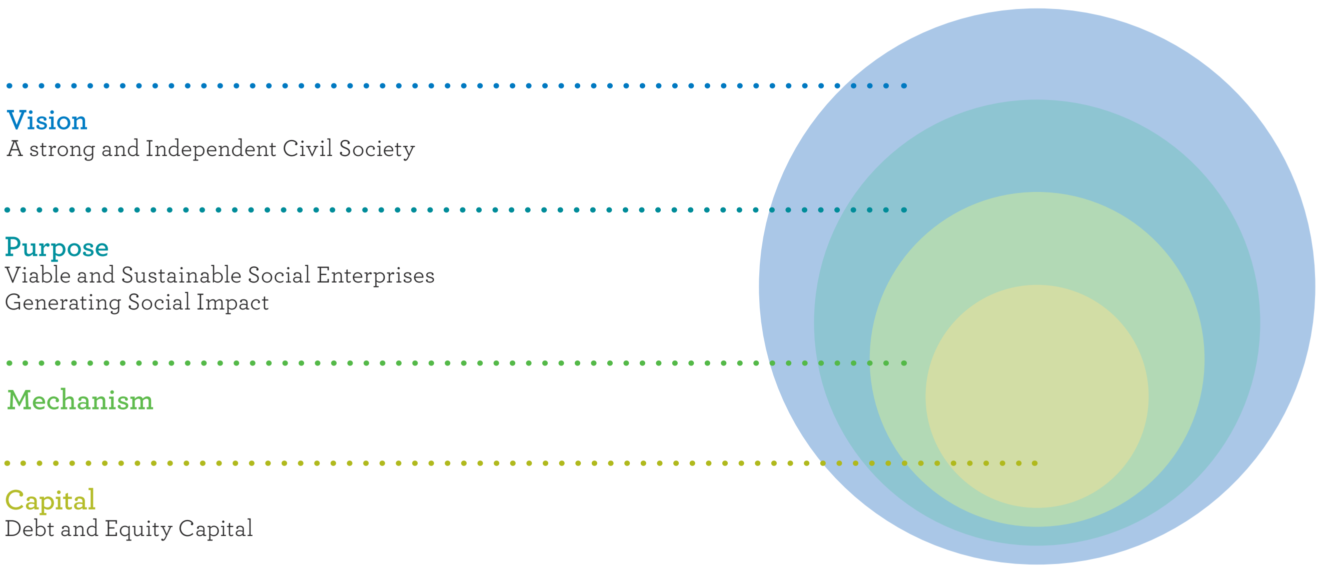
"service provider that offers input support services for (social enterprises) or acts as a conduit to connect two parties"
(Economics References Committee, 2011;p.xv).

More specifically, Shanmugalingam (et al, 2011;p.18) define 'social venture intermediaries' as:

"specialist organisations that combine:

- *A commitment to social goals*
- *A focus on ventures (rather than projects or programmes)*
- *An intermediation role, aggregating and matching finance, skills, physical collaboration space, evidence, technologies and networks".*

Fig 8 *Capital is one mechanism that can help to achieve the outcome of building viable and sustainable social enterprises*



They also identify five main roles of intermediaries in terms of developing and supporting social enterprises:

1. finance
2. people, networks and expertise
3. marketing and distribution
4. innovation
5. monitoring and evaluation.

Others have added to this list: roles of research, advocacy and design services. While it is recognised that all these roles are important in developing the Australian social enterprise sector, this report focusses specifically on the intermediation roles directly connected to finance and investment. Therefore the focus is on those intermediaries who play a direct or indirect role in the following:

- ***Investment-readiness intermediation*** - including intermediaries who are focussed on capacity and capability building, and those offering financial stepping stones towards investment-readiness, such as soft loans, patient capital, venture philanthropy and other funding options focussed on developing and building the viability of social enterprises, and perhaps priming them for future social finance (for example, Social Traders; Social Enterprises Sydney; SVA Hubs; Social Innovation in Western Australia (SiiWA)).
- ***Social finance and social investment intermediation*** - including intermediaries who design and deliver finance services and products that are tailored to meet the needs of social enterprises and focussed on helping them achieve viability and sustainability; and intermediaries who are building investment products and developing capital supply opportunities to increase the supply of capital to social enterprise investment (for example, Foresters Community Finance; Social Enterprise Finance Australia (SEFA); Social Ventures Australia).

These intermediation roles can be housed within one structure, and to be clear, most social finance intermediaries do provide degrees of investment-readiness intermediation as part of their engagement and due diligence processes. However, it is also important to recognise that specialist financial intermediaries may not be in the best position to offer investment-readiness intermediation across the lifecycle of social enterprises, particularly if their focus is commercially oriented rather than philanthropically oriented finance. Further, there is a danger of a conflict of interest if investment-readiness work is not separated from commercial determinations and assessments of finance.

Understanding Finance in the Lifecycle of Social Enterprise

Ensuring that there are pathways for social enterprises wishing to develop to a point where they are investment-ready and investable first requires an understanding of the lifecycle of social enterprise. Burkett (2010;p.12) highlights that this lifecycle is made up five basic phases, and that the journey through these phases is not always linear:

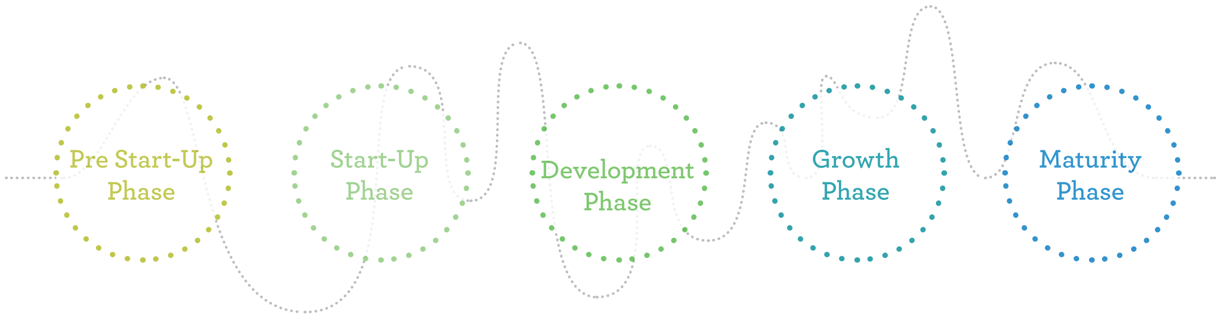
"enterprises often take a circuitous route on their journey towards maturity. Some spend longer or shorter times addressing certain issues or building certain products/services ... some jump ahead or go back to revisit certain phases of development".

This is summarised in Figure 9. From this figure it is clear that debt and equity finance are not always appropriate in the early stages of social enterprise development. However, there are important interventions that may be needed at these stages to ensure that social enterprises do have opportunities (and the capacity and capability needed to harness these opportunities) for finance when it is needed and appropriate. Thus, there are roles for intermediaries in these early stages - though these intermediaries may not be focussed completely on financial intermediation, they may provide important stepping stones leading to finance at a later stage.

Further, it is not the case that one single intermediary should necessarily be involved in the whole lifecycle of a social enterprise, nor in the range of interventions that could possibly build a pipeline of investment-ready social enterprises. The following interviewee articulates the range of intermediation needed across the lifecycle:

"The question is really, can one type of intermediary fulfill all the roles, or do we need different types of intermediaries? I think its important to point out that its not necessarily about the creation of new organisations, but its important to work within existing infrastructure as well. ... So when I think about it there's a capacity building type of intermediary that has the knowledge of the types of business skills that are required to develop an enterprise sustainably. Then there's an intermediary role of brokering deals between investors and investable organisations and then there's potentially a role for intermediaries in being able to help coordinate or bring together some of the market building activity. There's not necessarily a single role for (an) organisation in each of these - the challenge is to ensure that organisations aren't stepping over each other or around each other and thereby inefficiently using the allocated resources". (Government).

Fig 9 *Intermediary roles across the social enterprise lifecycle*



	Pre Start-Up Phase	Start-Up Phase	Development Phase	Growth Phase	Maturity Phase
Key Activities	• Exploring and refining social enterprise idea • Exploring and concept testing appropriate business models (for impact and commerce potential) • Putting together initial resources to test ideas in practice	• Movement from idea to action • Building initial infrastructure or equipment • Initial marketing, attracting first customers, networking • Accessing necessary technical assistance • Testing the business model - from commercial and impact perspective	• Developing key processes and systems • Attracting and retaining key workers • Stabilising cash-flow • Business and impact planning • Establishing track record • Building stability in the business	• Expansion and diversification • Decisions about scale and sustainability • Growing people and impact, not just income • Economies of scale and greater efficiencies and effectiveness • Leveraging and building business model	• Building from a stable base towards financial and social sustainability • Leveraging from reputation and asset base • Moving beyond an internal focus to broader sectoral focus • Longer-term business and impact planning
Key Roles for Intermediaries	• Support for articulating business model • Sounding-board, feedback and honest assessment about feasibility of business models and the potential of an idea to deliver social impact • Early-stage training, capacity-building, informal workshops	• Feasibility planning and development • Early business planning support and assistance • Training, capacity-building around business and trading • Network development • Brokerage of resources	• Development support and capability building • Targeted capacity support - for example, procurement support • Business planning and financial management support • Finance	• Financial assessment • Finance - debt, equity • Planning for growth and scaling - financial and impact plans • Support for reporting - linking financial and impact reporting	• Asset development and asset leverage • Longer-term business planning
Most Appropriate Sources of Capital	• Sweat equity • Crowd-funding • Internally sourced funds	• Sweat equity • Crowd-funding • Venture philanthropy and patient capital • Carefully structured grants	• Venture philanthropy and patient capital • Development finance (introductory debt finance)	• Debt and/or equity finance with commercially comparable rates and terms	• Movement toward mainstream finance

The importance of understanding the relationship between finance and investment-readiness or capacitybuilding intermediaries across the lifecycle was highlighted particularly by the following interviewee:

"Without doing the early-stage pipeline work there's not going to be that supply of enterprises that are ready to engage with finance because the capability is just not there and if there is to be a social finance market this is critical" (Intermediary).

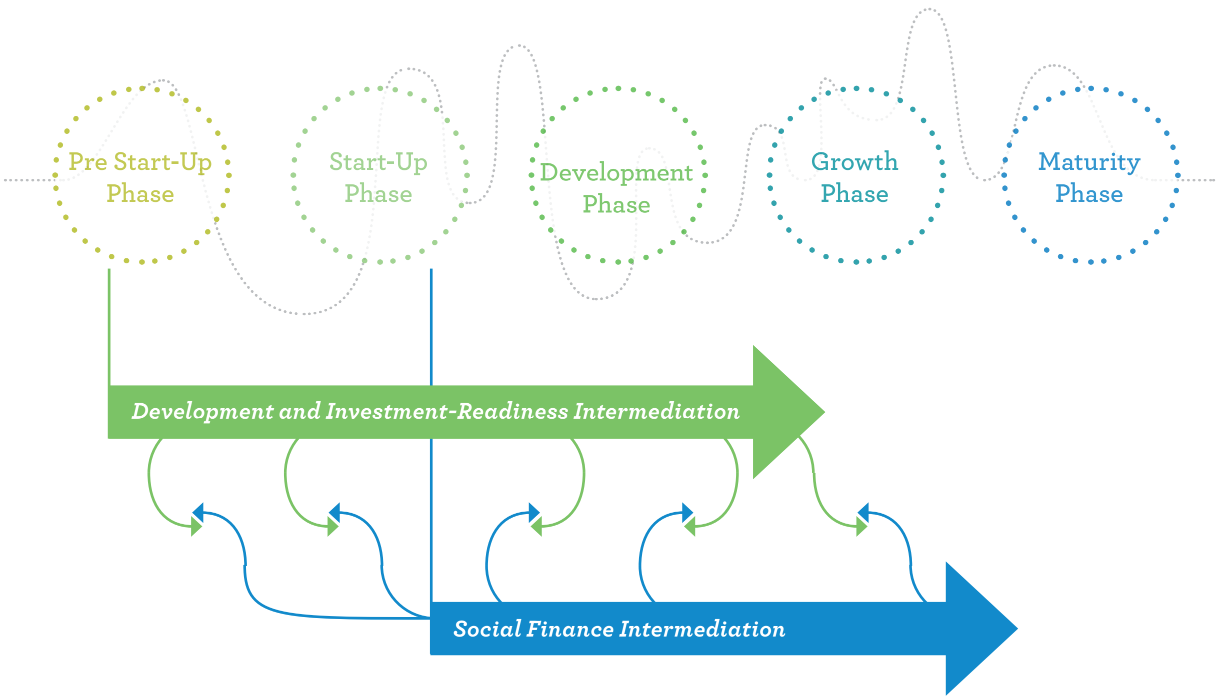
Further, it is not the case that development and investment-readiness intermediation is needed only in the early stages of social enterprise lifecycles (see Figure 10). This can extend across the lifecycle, right up into growth phases of development. Social finance intermediation, though it may be sought earlier, is most appropriate for established social enterprises. It is rarely suitable for stand alone start-ups, though other interventions including venture philanthropy may be relevant at this stage. What is clear, however, is that there needs to be feedback loops between investment-readiness intermediation and social finance intermediation, both in terms of having somewhere to refer enterprises to when they are not investment-ready, and having appropriate finance structures in place when enterprises are investment-ready and investable.

While we have distinguished different kinds of intermediation roles, these roles are not always distinct or separate - there are cross-overs and overlaps between these roles. So, for example, capacity-building is not limited only to investment-readiness intermediation roles - it is also embedded in social finance intermediation roles - as the following interviewee identifies:

"capacity-building is embedded in the financial assessment process - an organisation or enterprise is given open, transparent feedback and they then know whether they are ready for investment or if not, what they need to do in order to become investment-ready. That is capacity-building not just due diligence" (Intermediary).

What is important is that there are coherent and coordinated entry-points and pathways towards diversities of capital for social enterprises as appropriate across their lifecycle (see Figure 11), ensuring that social enterprises do not become 'stuck' with access to only one form of capital such as grants.

Fig 10 *The scope of investment-readiness and social finance intermediation across the lifecycle, and the feedback loops between them*



According to a number of interviewees the pathways between different kinds of intermediation roles and intermediaries across the lifecycle of social enterprise are not as clear as they could be:

"I don't think there are clear pathways. I think it's haphazard, ad hoc, at times, for the users, confusing, and I say that of ourselves as well as other intermediaries"
(Intermediary).

A recent research report from the UK argues that, despite a relatively well developed intermediary sector, the coordination and pathways remain patchy here too:

"Organisations found it hard to sequence the stages around investment-readiness provision and did not know when to look for finance and in which order to sequence their activities towards this goal. Those at early stages of interest in social investment are looking for step-by-step guides. Signposting is poorly coordinated and there are many gaps in provision, which is mixed and patchy across the UK"
(Gregory et al, 2012; p.v).

Social Enterprise Intermediaries in the Australian Context

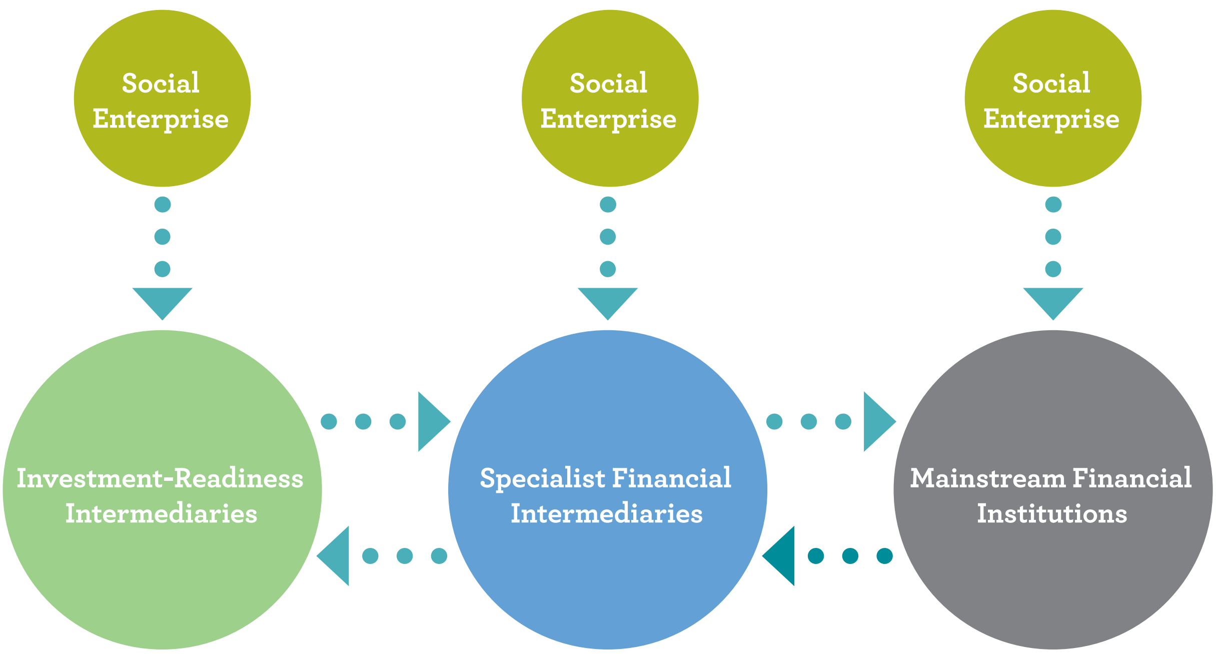
In Australia there is a less well developed intermediary sector than there is in places such as the UK. For some this limits the development of social enterprise:

"... If you go to the UK you will see there is a diverse, eclectic, interesting, sophisticated, intermediary market. It is very limited in Australia ... It is not a big group. And that is a real pity"
(Traill, in Economic References Committee, 2011;p.96).

Others, however, argue for caution in the creation of too many intermediaries. As one interviewee suggested:

"The danger in establishing new intermediaries is not having a distinct purpose for those intermediaries that's clear and consistent with other things that are happening in the market. We do need better targeting, better coordination, more appropriate role identification and some sort of consistency, collaboration and partnering to make better use of existing intermediaries"
(Government).

Fig 11 *An example of a coherent and coordinated range of entry points for social enterprises, and pathways between intermediaries so that needs and capital can be most appropriately matched*



This is also reflected in the UK experience, where research suggests that:

"There is evidence ... that the market for intermediaries needs to become more competitive and more accountable"
(Shanmugalingam, 2011;p.48).

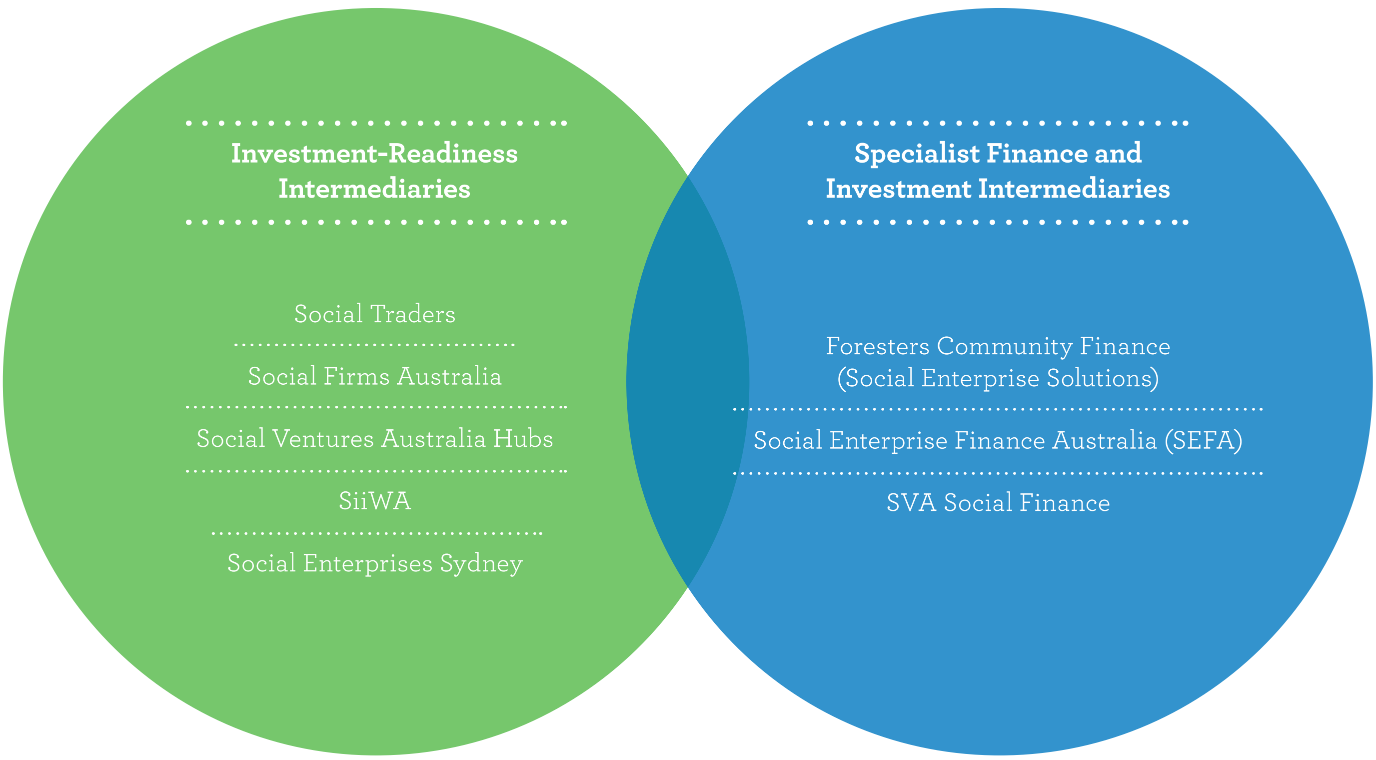
"As an emerging industry, (intermediaries) accountability, competition and transparency standards are yet to be commonly agreed, and without them the industry is vulnerable to accusations that it takes away revenues that ought to go to ventures themselves "
(Shanmugalingam, 2011;p.19).

In Australia there are several key intermediaries in the social enterprise sector that have some focus on finance, either in relation to assisting enterprises to become investment-ready, offering stepping-stone capital in the form of repayable grants, or in providing specialist /tailored finance into this sector. These are mapped in Figure 12. There are of course other social enterprise focussed intermediaries in Australia but these have core agendas directed at other parts of the development of this sector.

A recent injection of resources into increasing the supply of capital into the social enterprise sector (via the Federal Government's 'Social Enterprise Development Investment Fund' (SEDIF)) has increased a focus on the supply-side of the intermediation continuum. However it has also raised questions about whether investment into this market should be demand-led or supply-led, or indeed how a balanced focus is to be achieved. The following interviewees highlight the tensions of being supply-led:

"My problem is that when we speak to people in this space, they can cite very few examples, so we've got the same examples coming up from multiple sources, and that reinforces the view that there's not a lot that's kind of investment-ready yet. Everybody's telling us about XYZ (name of social enterprise) and not very much else, and we know the people from XYZ and we know the story and we know how good it is, but what's the next XYZ, and the next one after that, and the next ten XYZs. I don't doubt (the demand) is there - but I just don't think we understand the scope of it yet"
(Financial planner/advisor).

Fig 12 *Key intermediaries involved in finance or investment-readiness of social enterprises in Australia*



"... there are very few social enterprises with the financial nouse to really take on serious levels of debt or equity. (There is some work out there focussed on) getting these social enterprises investment-ready, (but) it would be great to see some more services so that we develop really strong and financially robust social enterprises that are then ready when superannuation funds, with really significant amounts of capital ... (are ready) to invest in them. I think it would be a shame to get (a lot of) the super-funds on board, ... and then for there just not to be the investment opportunities out there when the capital is ready to be deployed" (Investor).

"The problem is we've effectively developed funds that are not that different from what banks offer, and we haven't addressed the investment-readiness pipeline that is required to get organisations to the point where you can invest. If that doesn't happen, I think the funds will stay sitting on their capital" (Intermediary).

Further, there is a growing recognition that managing investment funds in relation to an underserved market such as social enterprises may not actually, in itself, be an intermediary role. This role requires a broader and deeper engagement with the underserved market that is its focus - as highlighted by the following interviewee:

"The fund managers themselves may not be the intermediaries - there's potentially a role for intermediaries to support the fund managers. There's a limit to how much fund managers can get out there and develop the pipelines of the investment-ready organisations and concurrently build the pipeline of investors that could help grow the business of the market overall. If you took a step back, you could think of the SEDIF fund managers as intermediary organisations or as mainstream financial institutions"
(Government).

What this highlights is that the role of an intermediary is about more than the technical management of funds that are focussed at underserved markets. It points to the need to understand the role in broader terms and to unpack all that is needed to channel capital into these markets - as this report highlights, this involves much more than merely managing and administering funds.

Unpacking the Roles and Work of Intermediaries Focussed on Financing Social Enterprises

Analysis of the interviews and review of the literature points to three key interconnected roles of specialist financial intermediaries in relation to social enterprise:

1. building investment-readiness
2. providing demand-led finance opportunities
3. growing and balancing the supply of capital

These roles are further explored below.

Building Investment-Readiness

One of the key issues raised about investment in social enterprises focusses on how 'investment-ready' they are. Almost all the interviewees spoke of the need to ensure that social enterprises are 'investment-ready', and many articulated the importance of this alongside growing the supply of capital.

This is an issue that is relevant not only in the Australian context, but one which has received international attention as a key limitation in growing the social enterprise sector - as highlighted by Croft (2010) in the UK:

"Investment-readiness is the single biggest barrier to growth for social enterprise, where it is not present. It restricts both a confidence in, and a greater flow of capital into, the market. It also perpetuates a culture of grant dependency. Becoming investment-ready can be a long and difficult journey but social enterprises face unprecedented opportunity for growth. The journey towards investment must start now."

The closure of the Triodos Social Enterprise Fund in the UK is often cited as an indicator of the shortage of 'investment-ready' social enterprises in this context. Though this investment fund was offering equity investments, it is regularly highlighted as pointing to a more general need for focussing on investment-readiness in order to generate deal flow and build an investment pipeline - as Hill (2011;p.69) highlights:

"The shortage of investable propositions has been a barrier to faster growth in this area, not the shortage of the finance itself. This is an important point to tackle when seeking to lever further capital. Triodos Social Enterprise Fund raised £3m to invest in growing social enterprises. It closed the fund after one year in 2010, with only one deal made, after receiving over 280 applications. The applications did not meet their requirements for near market rate returns offering equity investments. This suggests the need to provide investment-readiness training programmes ... There is also merit in determining whether availability of capital does, over time, itself generate the types of investment proposals that investors seek (by establishing successful standards)."

A number of specialist intermediaries and programs have now been funded in the UK to help build 'investment-readiness' (see for example, UnLtd - http://unltd.org.uk, Young Foundation - http://youngfoundation.org, CAN - http://www.can-online.org.au), through the £10m 'Investment and Contract Readiness Fund' established in May 2012. This allows enterprises to access funding to pay for capacity building from approved providers with a view to developing 'readiness' for investment (or readiness to compete for commercial procurement contracts). In a recent letter to the European Commission, the Chief Executive of Big Society Capital, Nick O'Donohoe reflected on the importance of incorporating investment-readiness into the landscape of social investment. He argued that investment-readiness support in the UK is beginning to have a material effect on the quantity and quality of the social investment pipeline, and that it was important that this work be offered to social enterprises on "favourable or even grant-like terms" (O'Donohoe, 22nd June, 2012;p.2).

One of the difficulties in advocating for a greater focus on intermediaries that can deliver 'investment-readiness' in Australia is that there is relatively little discussion about what this actually means in the context of social enterprise. Further, focussing only on 'investment-readiness' as the key barrier to opening access to capital in underserved markets can draw attention away from a need to also examine broader issues such as how capital structures can limit accessibility.

What Does 'Investment-Readiness' Actually Mean?

Many analyses about the 'investment-readiness' of social enterprises in Australia highlight deficits in planning, commercial literacy and business skills - as the following interviewee explains:

"Our work really is focussed on ensuring that there are more enterprises in a position, ultimately, to be capable of absorbing finance to fund their growth, and without organisations like ours, that's extremely unlikely. What we see is a real lack of planning and strategy in social enterprises in their early days and the ones that ultimately come through and survive that, it's almost by a divine combination of someone who is highly capable or intuitive in the organisation who makes it all happen but really it's not like a standard business where those kind of approaches and practices are learned behaviours if you like. So a lot of what we do with early stage enterprises is try and sort of open their eyes to and explore those learned behaviours and approaches into their planning and operations from the outset. The reality is that without that degree of sophistication in the way that they approach their social enterprise as managers, it is likely that they'll struggle to be in a position to access debt capital and other investment. There won't be that degree of capability to be able to access and manage debt" (Intermediary).

One the first challenges is that while many investors and intermediaries speak of the need for social enterprises to become 'investment-ready', there is relatively little articulation of what this actually means in practical terms - as is highlighted in the following excerpt:

"Investment-readiness is as basic as, if I was sitting with someone and thinking about lending them money, I'd want to be confident about getting my money back. With the vast majority of social enterprises I see, to be honest, I wouldn't be confident of getting my money back. Usually they don't have the market research, they don't understand their customers or their competitors, they don't have the right people in place, they don't have a business plan in place in terms of assessing the risks, they don't have a unique selling point - and probably it's a combination of all these things. So, in most cases I wouldn't lend them my own personal money, so I wouldn't lend them anyone else's money either"
(Intermediary).

Difficulties arise, however, when there are diverse interpretations of investment-readiness, or when there is a match between the work undertaken to support enterprises to become 'investment-ready' and the expectations of financiers or investors in terms of what they consider needs to be in place in order to invest in those enterprises. The interviews illustrate a lack of common frameworks - as one interviewee highlights:

"I think it's a completely uncoordinated market at this point in time. ... We are engaged in conversations with capacity-building intermediaries (about) what role they could play in early-stage development to help get the organisations 'investment-ready' - that's the language used. But my view of that is that if we don't agree (on) what investment-ready looks like, well all of that could be a waste of time. So 'investment-ready' from their perspective (may be) one thing, from ours it might be something quite different - and if we can join it up and create a common picture then we might actually be able to achieve the goal of co-investment, but if not, if it remains uncoordinated and unarticulated then no, we'll just dance around each other endlessly" (Intermediary).

The difficulty in developing standardised frameworks of what defines 'investment-readiness' is that it will mean different things depending on the types of finance /investment under discussion, and different investment parameters set by investors. This is highlighted by the Young Foundation in the UK:

"What is meant by 'investment-readiness' varies according to the nature of finance sought and the investor themself. An investor providing a bridging loan to an organisation who has a short-term financing need will have a different set of requirements of the investee than one who is considering a longer-term quasi-equity investment, for example to fund the development costs of expansion or a new trading activity, where the underlying risk is inherently greater. While this means that investment-readiness is not a static position, easy to define, it is also means that there is no check list of tangible benchmarks that will guarantee you are successful in seeking social investment. Becoming 'investment-ready' requires a holistic assessment of an organisation from its vision and people (what we term 'skill and will'), its business plan, financial projections and organisational capacity to deliver the business plan, through to the social impact ... and how this aligns to what social investors are looking for" (Young Foundation, 2012).

This is a critical point, particularly as some of the investment-readiness support currently available in Australia is structured around certain mechanisms, such as developing a business plan, rather than around more holistic assessments or assessments focussed on particular forms of investment or philanthropy. For example, one intermediary focussed on building investment-readiness suggested a business plan could be the basis for accessing a variety of different capital:

"The vision I suppose is that there will be a pathway for them, ... (our) main offer (is) around the development opportunity ... so that more individuals and organisations ... (can) ... come out the other end with some really robust and solid business plans, that then gives them the opportunity to go and access finance from it maybe philanthropy or it might be government or it might be the SEDIFs, or it might be commercial sources of finance as well, or other social investment" (Intermediary).

Fig 13 *Key elements of social enterprise investment-readiness assessment*
Source: various

Organisational Structure and Culture

» ***Leadership and Vision***

» ***Governance and Management Alignment, Track Record and Credibility***
to drive vision and manage finance/investment

» ***Culture of Innovation, Risk Management and Impact***
to deliver on impact and financial agendas

» ***Legal Structures, Policies, and Plans***
in place and utilised to support social investment

Purpose of Loan

» ***Purpose Aligned***
to building viability and sustainability, achieving social outcomes and is financially viable

Documentation and Presentation

» ***Clear Financial Records***
distinguishing restricted and unrestricted income; trade generated income and funding

» ***Business Plan***

» ***Financial History and Projections***

» ***Legal Structure Documents***
showing things such as asset locks; any investment structures (eg. equity restrictions)

Capability

» ***Skills and Knowledge***
to manage and leverage from finance/investment

» ***Track Record of Credible Pathways***
for generating revenue and social outcomes

» ***Networks and Connections***
to support development

Investability

» ***Fit With Investment Parameters***
according to due diligence assessment

» ***Repayment/Returns Assessment***

» ***Credible and Realisable***
realistic financial and social outcome projections

Outcomes and Impact

» ***Framework***
for tracking and measuring outcomes

» ***Evidence of Social Outcome***
achievements to date

There is, however, a recognition that the business plan is only the output of a deeper process:

"Business planning is more than just producing a plan document but a process whereby knowledge, focus and skills are transferred and built up in the enterprise. In other words the plan itself is a demonstration of the capabilities that have been built and what is needed to execute"
(Intermediary).

Still, it is clear from both the literature and the interviews that 'investment-readiness' is as much about changing organisational culture as it is about developing a business plan, and this requires a 'transformational' approach to support a transactional approach. The following interviewees highlighted this:

"One of the key issues around social enterprises and their access to capital is really their investment-readiness – and that hasn't been helped by a reliance on grant funding that hasn't really required them to build the same the sort of financially sustainable business models that other commercial enterprises who don't have access to grants usually would need to develop in order to survive in a commercial environment. ... I still think there's a shift in culture needed from an expectation of ongoing grant funding to one which requires thinking a little bit beyond that. And automatically that introduces an element of risk that may not necessarily be the most comfortable place for social enterprises - so there's a challenge in there in being able to understand risk, be comfortable with risk and be able to manage that risk ... .So (that is part of the process to) build up their capacity to become investment-ready, and by that I mean developing the appropriate longer term business models and more sustainable funding sources be it through investment, grants or revenue streams that help them develop a sound footing from which they can forward plan other activities rather than building their business plan around opportunities presented when applications for grants appear"
(Government).

"There's also a kind of paradigm shift that happens in organisations, particularly if they've grown out of the community sector, or more traditional not-for-profit organisation to even contemplate debt - for their boards, for example, to even contemplate taking on debt. There's a capability shift that needs to take place in organisations, but there's also an attitudinal paradigm shift that needs to take place, across the governance structure, to be able to take up the kind of money that's now out there"
(Intermediary).

Clearly investment-readiness is broader than business planning and objective financial measures and involves changing both culture and practice in social enterprises (Mason and Harrison, 2001). Figure 13 above outlines some of the key elements that could be incorporated into assessments of 'investment-readiness' as highlighted across the social enterprise literature.

Finally, it is important not to interpret a lack of 'investment-readiness' as representing an overall 'deficit' in social enterprises:

"There is also a danger that talk of the lack of investment-readiness (of not-for-profits and social enterprises) implies that somehow the sector is failing, and worse, that this is somehow the sector's fault. In fact, many organisations are overcoming significant odds and doing a remarkable job in surviving and continuing to deliver crucial services to the people they exist to serve"
(Gregory et al, 2012;p.10).

At What Stage Should Social Enterprises be Helped to Become 'Investment-Ready'?

In many of the interviews 'investment-readiness' was used as a blanket term for all the capacity and capability that a social enterprise may need to take on finance and/or investment. As suggested above, there was little articulation of what constituted being 'investment-ready'. It may, however, be the case that 'readiness' is broader than just 'investment', and different capacities and capabilities may be more appropriate over the lifecycle of a social enterprise, as Temple, (2012) argues:

"..our experience is that investment-readiness comes after business readiness and finance readiness, which means getting the organisation's operations and financial management ship-shape, even before you look at investment."
(Nick Temple, 5th June, 2012).

This need for broader support before any focus on 'investment-readiness' is recognised by intermediaries in the Australian context, as the following interviewee articulates:

"... we're focussing on the organisation or the nascent organisation. It is about helping people to explore, generate and evaluate ideas, so, there's direct support for people who come to us with an idea. At the earliest stage it's about people coming to us with an idea that we think has some merit and is worthy of putting some more work into in terms of testing its feasibility and then potentially developing it. And then potentially us investing in it but also helping them access other capital to get that idea off the ground. And then right through to enterprises that are operating but aren't yet sustainable, and so again that may be because things weren't going to plan, or there was poor planning at the beginning, or they were under-capitalised, you know, a whole range of reasons, but again working with them till they get to a stage of being more sustainable. Obviously beyond that there will be a point at which they want to grow. And if that's the kind of growth that focussing on growing the existing business or scaling or replicating, then we don't tend to focus on that as much in our direct support work. Clearly there is a need for that support to happen, but that's where we see other organisations operating" (Intermediary).

Further, very early stage support, focussed on impact-centred business models and trading basics can help to 'weed out' those that are not likely to represent viable enterprises. Given the fervour for social enterprise in Australia currently, such entities may still manage to attract funding or donations despite adopting business models that are highly unlikely to succeed (either from a business perspective or from an impact perspective). Support intermediaries can help identify such social enterprises early and can therefore clear the potential investment pipeline in addition to building it, as highlighted by the following interviewee:

"... (our decision to focus on the early stages) was a pragmatic decision around area of need and area of market failure, but it's also a good area to focus on, to advance social enterprise in Australia more broadly, it means that good ideas are getting an opportunity to advance and grow, but similarly we can assist people to cut off at the pass ideas that really don't stack up, from the outset, so you're not getting ideas coming through that can potentially attract philanthropic funding or other financial support inefficiently, if you like, because the idea doesn't have merit from a social enterprise perspective. It may be a fantastic idea that attracts attention, or it may have a great social purpose, but part of our job is helping to weed ideas that aren't necessarily going to work, and to build capacity of people at that early stage to execute them to their best capability as well" (Intermediary).

Gregory et al (2012;p.14) suggest that these roles of filtering out organisations are critical, but still only patchy in the UK:

"The absence of a filter and/or weak, patchy or ineffective signposting, partly explains the poor conversion rates from applications to loans ... On occasions, investors do make good use of the filtering that competitions, award schemes and other selective programmes offer to 'pick off' those which ... are closer to the 'bulls-eye' of securing investment. But without proper signposting and access to support, the market does not appear to operate very effectively."

What Does it Cost and Who Will Pay?

One of the key issues in supporting social enterprises to become 'investment-ready' is that such support is costly. As the Young Foundation (2012) argue:

"Becoming investment-ready can require significant capacity building which organisations do not always have sufficient resources to meet internally".

This is not specific to social enterprise support. As Mason and Kwok (2011) highlight, even building the investment-readiness of mainstream small to medium sized businesses is expensive and time-consuming. Because of the need for a long-term commitment, and the expense of generating outcomes, such programs are still relatively uncommon around the world.

One of the interviewees estimated that their flagship social enterprise support and development program costs around $12,000 per enterprise (and potentially more, as this figure excludes the cost of finding and supporting mentors). Another interviewee argued that costs of developing investment-readiness should be made more transparent:

"There needs to be more honesty in the discussion about the cost of investment-readiness - in our research it's about 20-30% (of overall funding or finance) and that's currently hidden and it's off people's books. If you don't have that discussion about that this is part of the actual impact cost of getting these businesses prepared to deliver a joint

social and commercial purpose, over the long-term no body thinks they've got to pay it and then they end up with businesses failing or failing to thrive"
(Intermediary).

Though these cost estimates may seem significant, if this helps to build a thriving and sustainable social enterprise sector then these costs will be offset with myriad social benefits. However, it is clear from the interviews that some thought needs to be given to how to pay for these costs given that they are unlikely to be covered fully either by investors or investees:

"We have lots of approaches made by a variety of organisations where it's obvious pretty quickly that they're not in any way investment-ready, but they come here with some view that we're going to support them to get there, but that's not part of our core job, so that causes us significant challenges. If we take the view that we should refer those organisations elsewhere, quite honestly, it just doesn't work ... there's massive barriers in terms of accessibility of those services. Many of the organisations at ideas phase can't afford the fees that would be charged, and there's not an orientation to innovation at this stage to that approach"
(Intermediary).

"Building the investment-readiness is an important part of it - and that's clearly a philanthropic activity - you're not going to get a return for this work".
(Financial planner/advisor).

The UK Government's £10m Investment and Contract Readiness Fund recognises that:

"As much-needed social investment impact funds become available, it is vital that social ventures are in a position to be able to take advantage of them to play a transformative role in how social value is delivered to our communities"
(Investment and contract readiness fund, 2012; www.beinvestmentready.org.uk).

Others, however, argue that focussing only on grant moneys to fund investment-readiness potentially undermines the 'entrepreneurial' spirit that should be at the foundation of any social enterprise:

"I'd question whether capacity-building and developing investment-readiness should be solely funded by grant money – if an organisation is entrepreneurial, and investible, it will be able to do a lot for itself. I'd be skeptical about funding an organisation just to develop investment-readiness"
(Sattar, in Evenett and Richter, 2011;p.58).

In Australia, though there has been some support for investment-readiness intermediaries, this has been somewhat limited both in terms of reach and scope. Now that the supply of capital through the SEDIF specialist funds has been increased, growing the pipeline of investment-ready social enterprises in a coordinated and intentional manner has become a priority.

What Methods are Most Appropriate?

If, as argued above, 'investment-readiness' is about more than preparing documents and plans, then it is also the case, as New Philanthropy Capital (2012) argues that: "We need a greater range of investment-readiness support out there, and more of it". One interviewee argued that this was certainly the case in Australia:

"Capacity building is a really fraught area - it needs a good injection of creative thinking. Business mentoring, business planning - it doesn't matter whether you're talking social enterprise or not-for-profit organisation, that's what you hear as the dominant approaches, and I don't think its tailored enough ... You end up either in these highly costly one-on-one approaches where an intermediary is working its way through a process with an individual enterprise, or you're going to these higher level business mentoring strategies which don't have enough focus to them to help an enterprise get structurally ready or financially ready. And the financial stuff is a major missing factor in all of this. We can look at a set of financials and see whether an organisation is investable. But the quality of the financial material we receive is really underdone, and you could shorten our transaction times by putting in place some highly focussed, specifically oriented capacity building just around the financial dimensions of these organisations - that would really make a big difference"
(Intermediary).

Recent research in the UK has pointed to the need for more generic information and diagnostic guidance in relation to investment-readiness - and particularly self-diagnosis options in early stages of an enterprises' development (Gregory et al, 2012). This can then be complemented with more bespoke and tailored approaches to capacity-building when enterprises are ready culturally and financially to engage in exploring capital options.

While specific investment-readiness methodologies in the social enterprise field have not yet been adequately evaluated or researched, it is worth reflecting on the lessons learnt from mainstream SME investment-readiness interventions. Key researchers in this space, Mason and Kwok (2011;p.16), argue that:

"investment-readiness is much more than preparing a business plan. ... Moreover, the value of investing 100 to 200 hours in writing a business plan is increasingly being questioned. Investors are placing less emphasis on the business plan."

In their research they have summarised some key learnings that may provide valuable reflections for investment-readiness intermediation in the Australian social enterprise sector. Key lessons are summarised in Figure 14.

Fig 14 *Key lessons learnt from investment-readiness programs for SMEs that may have some application for investment-readiness intermediaries in the social enterprise sector*
Source: Mason and Kwok, 2010; Sullivan, 2000; Barrett, 2006

Staged Process Involves different stages: awareness raising and finding out; becoming investment-ready; and finding investments	**Separate Support and Investment** Needs to be a formal separation of support and investment decisions	**Delivery Team is Key** Expertise, experience and networks of the delivery team is a critical success factor
Long-Term Commitment Develops over several months rather than just attendance at a one-off workshop	**Involve Investors** Involving potential investors in delivery of support adds creditability and realism	**Customisation Increases Success** But is costly, and there still needs to be a basic continuous pathway
High Cost Cost of delivery is high as face-to-face is most effective. Online requires high initial investment	**Mentoring Builds Confidence** Mentoring opens networks and builds confidence, but does not necessarily increase sales or jobs	**Power of Local Networks** Linking entrepreneurs to local networks and ongoing relationships continues the benefits
Group and Individual Delivery Combinations of group and individual delivery are most effective	**Entrepreneur Mentors** Mentoring is most effective if mentors are entrepreneurs (not just corporate employees)	**Importance of Evaluation** Investment-readiness programs require ongoing monitoring and evaluation to test if they are making a real difference

Providing Demand-Led Finance Opportunities

Once a social enterprise applies for finance, different intermediation roles come into play. It is not the case, however, that capacity and capability building suddenly stop nor that all enterprises applying for finance are actually 'ready' to do so. However, negotiating investment means that the capacity and capability building becomes much more focussed and tailored around actual assessments of readiness and investability. As proposed above there is a need for feedback loops in the process so that those enterprises who are assessed as not ready or investable are able to access further development support.

For social finance intermediaries focussed on underserved markets, it is important that the point of differentiation between them and mainstream financial institutions is centred on a demand-focussed, tailored product that will deliver on both financial and impact terms. As one interviewee argued:

"Our finance products are demand-led. They are not 'off-the-shelf', (it's not like), here's the product that's boxed up, with a ribbon on it, and when you open it up, if you don't like it, then that's too bad - (in our work) we sweep that approach aside. We've got a broad set of parameters around (financial) products - it is debt, there is an interest rate, you have to pay it back, principle and interest, some of it could be secured, some of it might not be, we will look at interest rates according to risk, and there's a broad set of terms, anywhere between two and fifteen years. So you can see it's a fairly open set of parameters, and then for each social enterprise that comes through the process of application and due diligence, an actual finance deal is shaped to meet the needs and requirements of their particular project. So, if it was an asset purchase, we would be looking at a whole range of factors related to term, serviceability, property location, and each of those factors will change depending on whether we're dealing with an organisation from a regional area, from a CBD area, from a specialist property point of view, or from a non-specialised point of view. So it's very tailored to each organisation, and what houses all of that is the process itself. So, we take organisations (through a series) of steps ... from application, through due diligence, and then through the submission process to the investment committee, so really by the time we've got something to the investment committee all the hard yards are done, and by then really only very rarely, barring a few questions would we then be in a position where we would be knocking deals back - because all the hard work has been done to shape the deal up beforehand. So it's really highly tailored. If you compared it to what's going on in a mainstream financial institution, you'd start to see why it's not such an attractive market to the mainstream, and that really comes down to the time. (In mainstream finance) if you don't fit the mould, maybe, you don't fit the risk profile of the standard bank product, you just don't get a look-in" (Intermediary).

It is important to understand that loans made by social finance intermediaries are assessed using commercial terms - they are not subprime loans, and they are made using risk management criteria that would be recognisable to mainstream financial institutions. There is a pervasive and unhelpful assumption in the Australian finance sector that any tailoring of processes or any offering of finance outside mainstream institutions automatically means that there is a deficit in loan assessment, or that what is being proposed is submarket. As one intermediary explains, however:

"It's a mixture of using the mechanisms of finance and investment, so (using) market mechanisms and (the) finance products and investment structures do not look very much different really to what you would see in the mainstream, except that they tend to be led more by the demand, so they are more tailored, but they take into account all the ordinary issues of risk and return, repayment - in the end, the point is that we must avoid engaging in any outcome where you make a subprime loan - let's be very clear here - it's not about sub-prime or sub-market lending in any form - not on interest rates and not on the structure of the loan" (Intermediary).

What differs is the process used to work through an assessment, the level of tailoring, the nature of the feedback given to an enterprise and the time taken to walk through and work through the loan process. In other words, intermediaries are not merely 'tweaking' transactional tasks in the process, but ensuring that the process itself is ‘transformational’. In other words, that it actually goes beyond ‘access to finance’ and goes some way to ensuring that finance is actually building the viability and sustainability of social enterprises, and thereby helping them to deliver on their social impact. Again, for intermediaries who identify as Community Development Finance Institutions (CDFIs) the ‘transformational’ work represents the ‘Community Development’ part of the process.

The work of an intermediary engaged with social enterprises incorporates dual and complementary processes - transaction and transformation. They are complementary because, as Thomas (2008) argues:

“ ... transformational CDFI credit offers a virtuous cycle whereby the CDFI’s transformational services decrease the risk of credit provided by the CDFI - that is, the likelihood of a loan going into default is ideally reduced with transforming services such as business counseling”
(Thomas, 2008;p.134).

Further, as the following interview suggests, such processes can also help reduce the perception of risk for funders, investors and the enterprises themselves:

“(Financial intermediaries take a) thorough look at the organisations that are interested in taking out a loan so they are really making sure that an organisation isn't putting itself at risk ... (As a government funder) I like the (intermediary) model particularly because of their capacity to make sure that we're not getting organisations into trouble by taking them down the road of borrowing ... So they ... provide some protection and they assist the organisation, its board, and its senior management to change the way they think about ... becoming a “debt ready” organisation. I think an intermediary like that, has an educative role, a linking role between the money and the potential borrower, and I guess they also have to provide some confidence to the lender that the projects they are undertaking are sound”
(Government).

Table 4 outlines in more details some of the key financial elements that can underpin more demand-facing designs used by social finance intermediaries. Unless these elements are addressed within intermediaries, there will continue to be barriers for social enterprises to access funds, as the following interviewee highlights:

“The security issue for social enterprise is significant. In the structuring of the (current) funds I think this has actually proven to be quite a significant barrier for a lot of organisations to access those funds. It needs to be looked at again”
(Intermediary).

The need for transformational processes is also not well understood by mainstream financiers, who often continue to believe that the key barriers are information and presentation, and that any social finance options are by definition, concessional or sub-market - as is indicated by the following interviewee:

“I think the argument that is usually made is that underserved customers aren't bad customers, their repayment rates are solid and default rates are low, but they're just underserved - the banks haven't thought outside the square, and are very inflexible in their approach. Well if that's the case, intermediaries can help change the perception of the banks and make it easier for those organisations to get bank lending at reasonable rates and that would be a very significant and leveraged activity ... (that way) you don't have to go out and raise the loan funds because the bank's got plenty of loan funds - you just need to go out and help the organisations present themselves to the banks in a way that makes it clear that they are actually serious about meeting their obligations.

So there's potential there for intermediaries to have a lot more impact by helping to get both sides to the table, speaking a common language - with a bit more empathy for the banks and a bit more evidence of clear organisations that are investable. And maybe that's all you need. The argument that you need to set up a special fund to make loans on a concessional basis, suggests that these ... organisations aren't able to stand on their own two feet without help in the form of lower interest

rates, and that's a different argument. I think the underserved market is not about that it doesn't have access to capital, but because the only capital it has access to is expensive capital."
(Financial planner/advisor).

Another interviewee suggested that this is reflected more broadly in the finance and investment sector with a lack of understanding about the potential synergies between finance and social impact:

"I think there's also a lack of understanding broadly out there in the (investment) world about the actual viability of combining social impact and financial return. I think its still mostly viewed as a bit of a zero sum game where one has to be sacrificed in the name of the other. That's not the case and obviously a lot of the financial intermediaries know that that's not the case. But it would be great if that general awareness was stronger out there in the broader community. There's still a bit of a dichotomy .. of .. its either social change and charity, or financial return and no social change"
(Investor).

There is, however, an understanding that it takes more time and more work to engage with and broker financial deals with social enterprises and that this in turn has cost implications which need to be factored into pricing. The following interviewees reflected on the implications of this for intermediaries and investors.

"The costs and pricing is also important and I do think that intermediaries need to factor in pricing into the way in which they value their operations ... We know that, at the end of the day, the commercial terms of the loan aren't dissimilar from

Table 4 *Designing demand-facing finance: how impact shapes finance process and product*

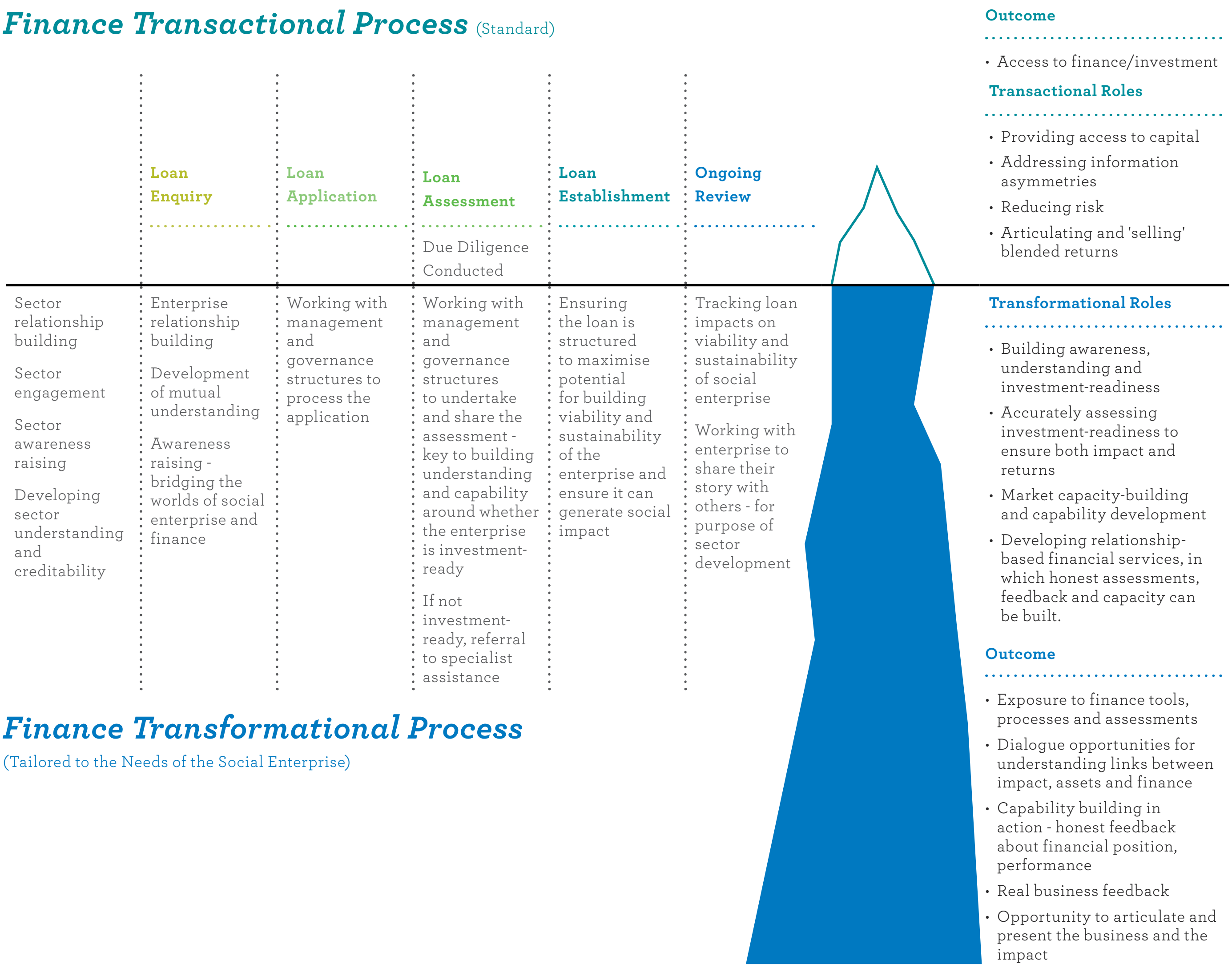
Financial Design Element	Dimensions of These Elements That May Need Tailoring in Social Enterprise Markets	Important Aspects to Bridging Demand and Supply-sides
Risk management and tolerance	• ***Security/Collateral*** may not always be available or may need some innovative responses (such as is the case with peer-lending models) • ***Links between risk assessments and pricing*** may need some reconsideration • ***Credit risk management frameworks*** need to be both rigorous, responsible and flexible in order to consider both the viability and the purpose of the loan. There may also need to be some capacity for tailored responses because 'one-size fits all' may not work as well in underserved markets.	• Finding ways to address a lack of collateral is critical as often this is a key barrier to accessing debt capital for social enterprises. Also requires risk management that doesn't merely shift responsibility to voluntary board members • Developing specialised understandings about underserved markets (a lack of which may lead to perceptions of increased risk), and due diligence frameworks that build deep understandings of particular underserved markets.s
Terms	• ***Terms and conditions of loans*** may need to take into account the impact and purpose of loans (in addition, of course, to repayment and returns).	• Social finance intermediaries need to combine financial rigour with tailored flexibility. Terms and conditions are often key to the latter.
Pricing	• ***Transaction costs*** are much higher in intermediaries focussed on underserved markets - because the transformational processes need to be incorporated into transactions. This needs to be considered in terms of externalities and returns.	• Social finance loans to social enterprises from specialist financial intermediaries are not 'soft'. They are commercially priced, and the transformation costs need to be 'sold' either to investors or to other stakeholders interested in the social benefits of the loans.
Exit strategies	• Certain types of investment need to consider the impact of exits on social enterprises (eg. equity investments; and time-limited funds).	• Careful planning, ongoing engagement and transparency can help enterprises prepare for exits.

mainstream financial institutions because they need to operate on a sustainable basis too, and that the most significant difference is the amount of time that's spent with the SE to build up an understand their ability to service the loan, which is time that is not invested by the mainstream financial institutions, which at the first hurdle will knock SEs out of the race. So pricing in that element of the business is important" (Government).

"It makes sense for these funds to have a higher than average administration cost because of the extra work involved. I don't mind (how those costs are covered) - if someone else will fund those costs then the investor can get a little bit more, which makes it more attractive, but if the investor has to fund those costs, then I guess at some point the investor will say, well, I need to do better than that" (Financial planner/advisor).

Certainly there is a need to more clearly articulate the 'transformational' dimensions of an intermediary's role in relation to social enterprise finance. These are very rarely discussed in anything but very broad terms, and to the unexperienced stakeholder they can seem somewhat obvious and fuzzy, whilst in practice they often underpin success in reaching and servicing underserved markets. Figure 15 examines some of the elements of the transformational roles, processes and outcomes that underpin the transactional practices of social finance intermediaries.

Fig 15 *Transactional and transformational processes, roles and outcomes*



Growing and Balancing the Supply of Capital

The catalysing role the Australian Federal Government has played in building the supply of capital focussed on social enterprises through the SEDIF initiative cannot be underestimated. As a result, at the present moment in Australia there is more supply of capital (in the form of debt capital predominantly) than there is demand and readiness for it amongst social enterprise. This points to one of the difficult balancing acts of intermediation in underserved markets - that of balancing supply and demand. As highlighted above, there are good reasons for intermediaries to be demand-focussed in relation to financing underserved markets, however this is not to suggest that there is no need to continue to build and secure adequate supplies of capital. One without the other will not lead to changing the flow of capital into such markets. One interviewee offered the following perspective on the interconnection:

"We need more capital - even though there's some money there already, if you get the investment-readiness part of the equation sorted then $40 million isn't going to be enough for what's required to really develop the sector. So we need to think about a lot more capital on a larger scale. But the capital is not enough"
(Intermediary).

There are three key dimensions of intermediaries role in relation to building the supply of capital:

1. growing and diversifying the supply of capital
2. ensuring a match between supply and demand to avoid a supply-driven push of capital
3. developing effective ways to measure and share outcomes and results.

These dimensions are explored below.

Growing and Diversifying Supply

Growing and diversifying the supply of capital for underserved markets requires a cross-sectoral approach rather than a reliance on only one sector to build the market. As one interviewee argued, relying only on mainstream financial institutions to undertake this work will not necessarily result in impact:

"If (a mainstream financial institution) were to do this, they would get some traction, but it would take a lot of work and the outcome would be relatively uncertain. They could do it, but I don't think they have a strong enough will to create the market - so therefore it falls back to intermediaries" (Financial planner/advisor).

From an intermediary perspective, however, the relationship between mainstream financial institutions and specialist intermediaries is critical for growing the future supply of capital:

"Mainstream financial institutions are critical, our future rests in part on the quality of those relationships, and on the clearly articulated view of those organisations that they wholesale to an intermediary that can reach down into the market. They are not themselves the deliverers of the outcomes, but partner with an intermediary who can reach into those markets"
(Intermediary).

Intermediaries not only play a significant role in reaching out and channeling investment into underserved markets, they also aggregate projects so that mainstream investors can invest in these markets at a scale that is efficient from their perspective, as the following interviewee highlights:

"The problem with most superannuation funds investing in the social enterprise space is that the deals are just too small. So for a $5 billion superannuation fund, they wouldn't look at a $1 million deal, its just not an efficient use of their time. If intermediaries (can) access enough social enterprises, pool them together and create a $100 million deal, ... then its big enough to grab their attention at least. A lot of the deals we see in the (superannuation) market are not less than $100 million, so I would expect something close to that (in relation to social enterprises)"
(Investor).

This highlights the need for an ecosystems perspective in relation to intermediation. Without a focus on growing the pipeline of 'investment-ready' social enterprises there is unlikely to be able to be such aggregation opportunities which in turn is likely to limit the supply of capital into this market over time.

Further, there is currently relatively little recognition amongst investors and mainstream financial institutions of the important role that such intermediaries can play in reaching underserved markets. Therefore, the role of specialist financial intermediaries in helping to grow and channel capital into underserved markets such as social enterprises needs to be recognised as part of a cross-sectoral emphasis on enhancing the reach into such markets. One of the interviewees highlighted the need for each sector to engage:

"I would like to see a time when 5% of every portfolio is invested in something like this, but I think that mindset's long way off. ... The intermediaries are essential to bundle up what the projects might be, and we can build this a little bit from the ground up, but to create a broader mind-shift where it becomes a common thing to investors, it might have to be led by the government, like the government might have to make very loud noises and say, 'we are investing in these projects, we are lending to these projects at a reduced interest rate' ... .they could make a big song and dance about doing that as well for community projects. ... . I think to really get it moving the government would have to be part of it. ... Or maybe if someone like (one of the big banks) made 2% of their portfolio along these lines, and if they were then to market themselves as doing so, those sort of things create a shift. It's got to be a big champion and it's got to come from the conventional space"
(Financial planner/advisor).

In order to grow and diversify supply of capital then, there are clear roles for intermediaries, government and mainstream financial institutions. The collaboration between these sectors could, according to a number of interviewees, bring significant new investors into the picture, and thus diversify the supply of capital, as is highlighted in the following quote:

"In terms of potential for superannuation funds to come into the market, I think there's a huge potential. ... If there's good returns to be made, then really you have to ask the question why wouldn't superannuation funds come in? Certainly there is a question of track record and this is an issue (in Australia because there isn't this track record as yet) but I think in terms of catalyzing those kind of deals, (if there are incentives - like) government guarantees (for) income investment like (is happening in SEDIF) ... then the deal becomes very attractive. I think one of the challenges for superannuation funds looking to move into this space, is really just finding the fund managers or the intermediaries with the experience and track record to actually aggregate the deals, put them together in a fund, and structure this in a way that is investable"
(Investor).

In overseas contexts such as the US and the UK it is also the case that success in growing supply of capital and increasing flows of capital into underserved markets has resulted from cross-sectoral initiatives (see for example, Bernanke, 2007; Pinsky, 2012).

The role of philanthropy in growing the supply of capital, particularly to support investment-readiness intermediation is also critical. But again, this requires a cross-sectoral approach rather than just a push to animate philanthropic activity in underserved markets such as social enterprise. This is highlighted particularly in the following quote from an investment-readiness intermediary, which points to the importance of structural enablement in increasing flows of philanthropic capital into this space:

"Unfortunately our organisation doesn't fit into the DGR categories under the ATO so we have to seek special listing and we have been pursuing that now for over 2 years. ... DGR is quite important for our longer term strategy because the philanthropic sector are interested in the sort of work that we're doing, they are interested in social enterprise and having access to that will be an important ... income strength for us going forward"
(Intermediary).

Growing social investment in relation to social enterprise would also benefit from a greater inclusion of the voice of philanthropy in the design of products and in the bridging of demand and supply, as is highlighted by the following interviewee:

"People that are coming out of banking and venture capital markets will approach finance products with their experience and will probably edge slightly down the social road. But we'll end up with products that come out of their experience. And then there's the whole group of philanthropic organisations that might actually bring about a different type of product - for them actually giving the money away and getting it back is an added bonus. And that same sector might actually be able to bridge some of the gaps that exist in this market and develop a set of different products"
(Intermediary).

In Australia's nascent social investment market the focus has been on growing the supply of capital from wholesale and sophisticated investors. While this has been an important part of opening up the supply of capital for investments into underserved markets such as social enterprise, there is also a need to explore how this can be expanded into the retail investment market in order to diversify supply into the future. This is highlighted by the following interviewee:

"There's a lot of enthusiasm (for social investment) from clients, but to date they've all been structured as projects for sophisticated investors, which puts them out of reach of about 85% of our clients. So while it remains in the sophisticated investment market, sure, it's bigger licks of money, but it means that for a practice like ours, we'd be able only to talk to about 15 or 20 of our 400 portfolios. So that is a limiting factor"
(Financial planner/advisor).

Finally, for supplies of capital to grow and diversify, particularly if there is to be a move to increase the supply of capital from retail investors, it will be necessary to consider how to engage the financial advice sector and new roles for intermediaries may evolve at this end of the supply continuum (see continuum on page 23). This has been highlighted as an important strategy in the UK:

"In order to bring the social investment market to maturity, it will be important to access capital flows from the large asset owner base in the retail market. A successful strategy for growing the market will need to include those who operate within the parameters of 'retail investment advice' such as financial planners and wealth advisors. These firms have a significant influence over the deployment of individual investors' funds under management"
(Elliot et al, 2012;p.7).

Intermediaries will clearly play a significant role in growing the supply of capital into the future - however, they will need to be joined by both mainstream financial services and by government in order to play this role effectively.

Ensuring a Match Between Supply and Demand

Growing and diversifying the supply of capital for underserved markets such as social enterprises is only one part of the challenge for intermediaries in this space. The other significant challenge centres on ensuring a match between supply and demand within the underserved market. This is not only about balancing a focus on supply and demand, but also ensuring that the types of capital that are supplied actually match the needs within the underserved market. The danger is that certain types of capital (for example, capital from investors seeking market rate returns) may be more readily accessible but may not match the growth of need or the readiness within an underserved market (so, there may be greater need for capital that helps enterprises develop investment-readiness). This dilemma has been highlighted by Social Finance in the UK:

"It is clear from our research that a growing number of financial intermediaries, social enterprises, charities and other social organisations are raising debt or other funds for investment and a range of new investors are being drawn into the market. However our research also reveals insufficient overall capital and mismatches between the capital available and market demand."
(Social Finance, 2008;p.1).

More recent research from the UK suggests a continuation of this mismatch between needs articulated by nonprofits and social enterprises, and the types of capital that are available:

"Organisations that are looking to raise finance are primarily interested in longer term finance of less than £100,000 to help them scale up their existing activities. This does not match the dominant type of capital on offer to this sector. Of the 21% of our survey who had been successful in securing investment, the majority secured longer-term loans … .with roughly half of organisations having to provide security to back this finance"
(Gregory, 2012;p.v).

In Australia it is important that investigation of the needs and readiness on the demand-side be further developed to ensure that, as the supply of capital grows, this is matched to needs on the demand-side, and that a diversity of capital needs can be met with a diverse supply of capital. It also needs to be recognised that commercially structured capital may not be appropriate for, nor reach, all parts of an underserved market, as the following interviewee highlights:

"There will be a group of enterprises that are never going to be able to access those SEDIF funds - particularly the ones that are aimed around the employment and support of marginalised people. Because if they're trying to maximise or balance the delivery of their social purpose against their business operations, then the reality is that they're always marginal. So their ability to take on debt is somewhat questionable potentially - or at least, pure debt - for them it may need to be a combination of debt and philanthropy"
(Intermediary).

Again, this highlights the balancing act that must be played by intermediaries seeking to redress the financial exclusion of underserved markets, and the need for a brokering role between demand and supply-sides:

"The sector must guard against 'pipe polishing' – developing ever-more refined products as a conduit to market without concentrating on the supply of capital and requirements of investors and what organisations actually need – bringing together the investors and the organisations who need investment is the starting point"
(Sattar, in Evenett and Richter, 2011;p.58).

For intermediaries focussed on reaching social enterprises it is also important that the supply of capital is actually needed in addition to being accessible, as is argued by the following interviewee:

"The danger is that we'll get to the end (and) people will say 'oh well, social enterprises don't really need investment because they haven't taken the money that was in the SEDIF, they're not investment-ready and there's just not a culture, rather than looking at the design of the program and process in terms of putting investment-readiness, business support and awareness raising around the market. We need to distinguish the funds from banks because otherwise people will say, as I've heard in one session, 'well, why would we come to you rather than a bank because the bank would actually offer a better deal'. That's the challenge we'll have over the next few years"
(Intermediary).

Developing Effective Ways to Measure and Share Outcomes

Measurement of impact has often dominated discussions focussed on the role of finance and investment in underserved markets. For many intermediaries the dominant message has been that capturing and measuring impact will lead to the opening up of greater capital supply:

"The market cannot scale without standardised, credible performance terms and metrics that have the same rigor as financial accounting measures"
(Katz and Bouri, 2012) (see also Bouri, 2011).

Effectively, impact measures are seen as a way to track the performance of funds that invest in underserved markets, which in turn is considered necessary for investor decision-making, as the following interviewee argues:

"As social investment emerges over time people are going to want to know how those types of funds perform - not just financial performance reports but also social impact performance reports and getting those measurement frameworks right is going to be critical over time. There's a range of measurement frameworks that we could potentially use, so I think there's a role for intermediaries in being able to help develop and test and pilot and lead by example demonstrating how effective some of these measurement techniques will be, and that in itself will lead to better information getting out there about the impact of this type of investment, a better understanding of how to analyse risk, and better pricing of social investment opportunities."
(Government).

Despite the benefits of developing measurement frameworks, the challenges of developing comparable, affordable and effective methods and mechanisms of impact measurements amongst intermediaries remain significant. First, there is a challenge of what to measure - for it is not the impact of the invested social enterprises that can be tied back to intermediaries, as is reflected in the following quote:

“We can't overstate our value in that. We have to be clear that what we are doing at the organisational level is operating to influence change organisationally, we're not directly impacting the service delivery of those organisations - we're not measuring that, we can't stand alongside that and say that's our impact - we have to be clear that it's not. I think it's a case of not overstating the intervention. I think it's quite simple in a way, it's really what we do in the end is provide organisations with a new way of doing what they're already doing,or a new way of growing or extending what they're already doing, or consolidating it in a way that makes them less vulnerable to the winds of change in terms of funding over time"
(Intermediary).

Second, there is the challenge of matching impact measurement frameworks with the performance information that investors are seeking. In the interviews there was little evidence that there is a strong demand for sophisticated impact measurements from investors. In response to questions about what form of impact measurement investors were looking for in making decisions, interviewees tended to emphasise narrative frameworks. For example:

“Our clients are looking for the actual human impact - the stories, the subjective stuff. They know the building is there - they want to know what's happening in the building. For them, these investments are more than money, more than numbers on a page. Let's be optimistic about humans - I think if it's got a human spin to it, then that helps a lot and so many people go for that if it was an option put in front of them where they could associate it with the benefit they're giving, people can see, you know, if through their investment they could see a disabled person in a home or a job - I mean that would be a wonderful company update or an update we could give to one of our clients”
(Financial planner/advisor).

“We do have a lot of conversations with fund managers on how they measure impact, but ... there's a fairly descriptive approach across those fund managers in terms of measurement. I think its one of those things that's obviously good to have ... but how we (report) it isn't an expectation from them. If you look at our last financial report for example–we put (social enterprise) kind of stories in there, because we think it gives value, it has a personal appeal to our (investors), I guess on where their investments are going. ... I would think our (investors) like that because then they can see on a personal level where their money is going. But there is no standard reporting requirements that we expect from our fund managers or that our (investors) expect from us”
(Investor).

Clearly this requires further investigation in the Australian context. Others, however, argue that ‘more is better’ in terms of reports about performance, so performance measures may enhance narrative reports in terms of enticing further investment. For example:

“The more you can tell people, the better, so if a community organisation or enterprise has managed to repay x amount of its loan and its programs are running to schedule and they're achieving their target, and if that's measured in as many ways as possible, then all that story is important to people who are putting money into these sort of things. They want to see that they are having an impact - and the better the story is, the more excited they are about doing that kind of investment or including it in their portfolios. I mean I see it as a positive reinforcement - I see that hopefully over time people will see this a part of their portfolios, and hopefully a substantial part rather than an exotic, 'only if we can afford it' kind of investment”
(Financial planner/advisor).

Finally, as yet there is no real evidence that sophisticated, highly resource intensive measurement methods actually do result in greater capital supply, so it is important that expenditure on developing these frameworks at the level of intermediaries is undertaken with an eye to the impact of impact measures. This is also summarised in international research:

“Even if the sector is able to produce standardised, high-quality methods for measuring the social impact of ... impact investments, the question remains whether this will drive greater adoption by the philanthropic field and more investment dollars to ... impact investing overall. Luther Ragin Jr., summed it up in this way: “I have yet to see an impact assessment of any of these impact measurement systems. At the end of the day, the value in measurement lies in the answer to this question: ‘Does it move capital?’””
(Tuan, 2011;p.29).

Conclusion

The provision of finance in underserved markets is not merely a matter of opening access to capital. In order that finance plays a catalytic role in creating pathways out of exclusion it is necessary to understand the nature of what has led to underserved markets, and what perpetuates them. Specialist financial intermediaries play an important role in the process, not only brokering and bridging between the demand-side (underserved markets) and the supply-side (investors and sources of capital), but also ensuring that processes are developmental (that, for example, there are support mechanisms to build investment-readiness) and that the finance will actually achieve positive impacts (rather than exacerbate or further the exclusion).

Intermediation roles focussed on financially underserved markets span the continuum of the demand and supply-sides of the market, and extend beyond just the provision of capital to include readiness, capacity and capability building. Further, intermediaries have the processes, knowledge and skills to be able to reach into markets that are deemed too risky or unprofitable by mainstream financial institutions. This means that there are significant opportunities for mainstream financial institutions to partner with specialist financial intermediaries and in this way channel capital into underserved markets in ways that are both effective and efficient, and that maximise impact.

In Australia to date the role of intermediaries in relation to the financing of underserved markets has not been well understood, or has only been understood in terms of transactional functions. Recent Federal and State Government initiatives to build the supply-side in relation to a number of underserved market areas has highlighted the need for greater investigation into how intermediaries actually work to bridge and channel this capital so that it achieves the social policy goals that underpin these initiatives. What this research has demonstrated is that success in relation to these goals will be based not only on how intermediaries structure transactions in these markets, but also how successfully they are able to enact transformation, such that the people, groups and sectors on which they are focussing will actually develop real and lasting capabilities and opportunities from engaging with finance.

In this research the following roles of specialist intermediaries have been highlighted:

- ***Investment-readiness:*** intermediaries provide specialist support, capacity and capability building that are focussed on helping people and groups to step onto a pathway towards accessing and participating in financial services. Effectively this is developmental work preparing and working with the people and groups to ensure that if access is opened, that they have the capacities and capabilities to be able to leverage opportunities from this access to different forms of capital. Without this intermediation the pipeline of investment-ready and investable entities in underserved markets will be limited.
- ***Demand-led finance:*** intermediaries develop finance products and services that are responsible, market-based and tailored to ensure that they meet the needs and objectives of people, groups and entities underserved by mainstream financial services. Being demand-led means that finance is seen as a means to an end, not as an end in itself. It means adopting a 'more than access' perspective, so that financial products and services are not only available, but are focussed on broader developmental goals.
- ***Supply that is matched to demand:*** intermediaries are focussed on ensuring that growing the supply of capital continues to match the needs of underserved markets, rather than leading to any temptations to push capital into these markets without impact or purpose.

This report serves as a way to extend the current dialogue and debate about the roles of specialist financial intermediaries in Australia with the goal of ensuring that they develop as a sustainable and valued part of the social investment landscape.

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