Ipsos MORI

thefairbanking foundation

HOW DO INDIVIDUALS BECOME SOCIAL INVESTORS?

Interim conclusions from research into the behaviour of high net worth investors

NESTA Making Innovation Flourish

A report written by: The FairBanking Foundation
Research conducted by: Ipsos MORI

NESTA would like to acknowledge the contribution of The Shaftesbury Partnership and Social Finance with developing the product stimulus materials that were used in the research.

Content

1. Introduction

A programme of qualitative and quantitative research into social investment is being conducted for NESTA. The objective is to identify the types of individual and products that are likely to be important in the growth of the market for social/community investment. A qualitative phase of research is completed and a quantitative phase of research had just begun as this report was produced. This report contains conclusions taken from the qualitative phase that are considered of sufficient interest for them to be reported upon at this early stage.

20 face-to-face or telephone interviews were conducted using a topic guide and stimulus material with individuals that had investment assets in excess of one million pounds, of which 6 were already investors in a social investment product. This was a sufficient number of in-depth interviews to enable common patterns to be identified. This group are defined as very high net worth individuals (VHNWIs).

The individuals had acquired or were acquiring their wealth in different ways. The shared characteristic was that they wanted their wealth to be managed well in order to produce a positive result and not be wasted.

This report does not contain recommendations, but the reader could use the conclusions to consider how social investment should be presented. It provides insight into how understanding among wealthy individuals can be improved and how this could lead to individuals having a social investment portfolio. The role that tax incentives could play is explored. Each conclusion could be used to develop policy recommendations or action plans.

The report describes the conclusions from this analysis, the potential consequences, as well as the quantitative research that is currently in process.

2. Conclusions

The conclusions are broken down into two sections. The first section describes the process by which an investor decides to include social investment as part of their portfolio of wealth. The second section describes the triggers and barriers that affect the motivations of investors engaged in deciding whether to make social investments. These triggers and barriers are specific to social investment and are different to those that apply to investment and philanthropic decisions in general.

2.1 How an individual becomes a social investor: a theory

Wealth can be deployed once the immediate needs of a family are addressed. For the VHNWIs interviewed it was used in two ways by all interviewees, which can be broadly defined as investment or philanthropy. There are many available investments from which the individual would construct a portfolio, possibly with the help of advisors. Investment could involve a pension fund that was likely to be managed on behalf of the individual. Philanthropy could take the form of gifts from wealth or of having a specific fund from which sums are given.

Diagram 1: Mindset transition to becoming a social investor

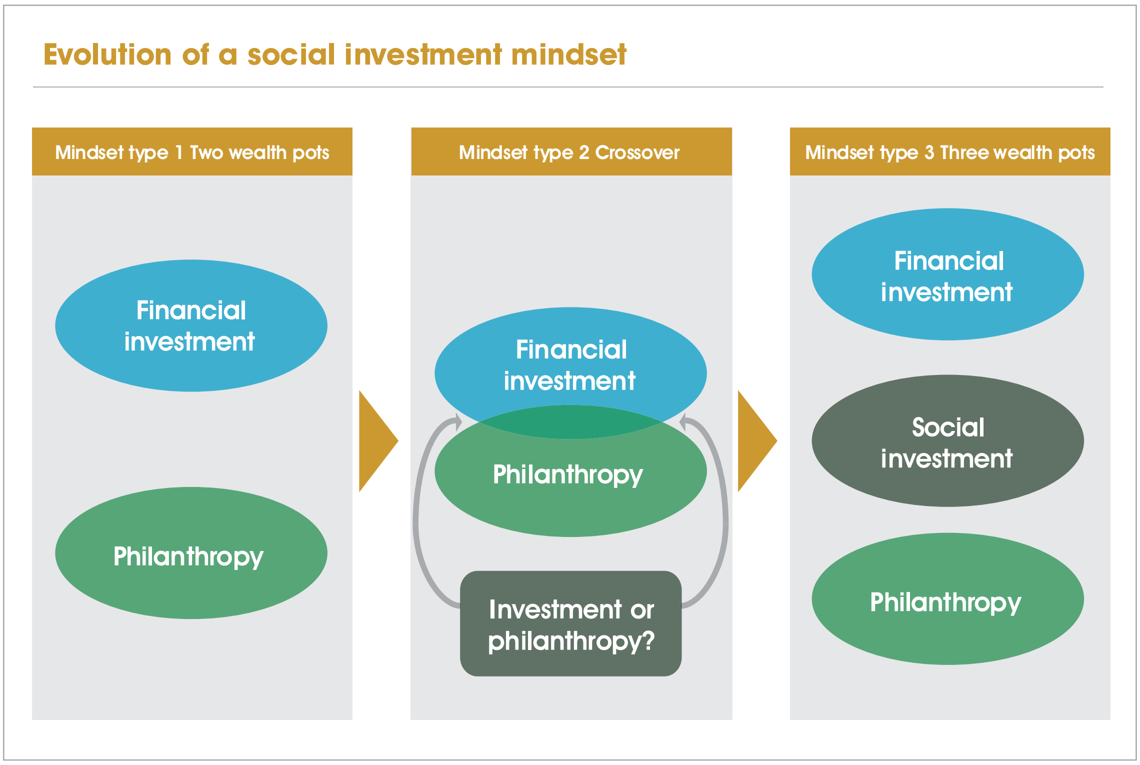


Diagram 1 illustrates that as people become aware of social investment, a process can occur that brings the two ellipses of investment and philanthropy into an area of overlap. This area represents confusion as to whether this way of deploying wealth is an investment or a philanthropic act. There is a realisation that there is a different form of wealth deployment, but it is difficult for the individual to categorise at this point. It shares characteristics of both investment and philanthropy, but is distinctive. This is difficult because the individual is thinking in terms of pots, jam jars or buckets and there is not a pot from which to allocate investment to this new activity.

Confusion as to whether this way of deploying wealth is an investment or a philanthropic act.

Transition is a gradual process, although it could happen quickly, depending on the character of the individual. It appears that there will be a period of discomfort as the individual improves their understanding of social investment. At some point even during this period of confusion an individual may decide to make an initial social investment.

"There is that dichotomy between the philanthropic and the pure investment and I suppose this is seeking to make some kind of bridge between them."

It is difficult to illustrate the realisation process that occurs in the diagram, but the reader is asked to imagine a third ellipse emerging from the confusion phase represented by the two ellipses overlapping in the second stage.

From this point, the wealthy individual recognises that there is a third category of potential deployment of assets. Social investment becomes a pot, bucket or jam jar in its own right. It is distinct from both philanthropy and investment with different motivations for decisions to allocate wealth to it.

Social investment is different; it involves an investment with a lower return for the equivalent risk with the purpose of meeting defined social needs.

In general, investment is viewed from the perspective of risk/return optimisation. Philanthropy is viewed from the perspective of meeting a social need. Social investment is different; it involves an investment with a lower return for the equivalent risk with the purpose of meeting defined social needs.

Social investment is sufficiently different from existing investment or charitable activity to mean that it emerges as a distinct form of wealth allocation. At this point, the individual will have a sense of contentment as to how social investment fits into their overall allocation of wealth. The decision-making process and monitoring process are distinct. The individual stops questioning how social investment fits with an investment portfolio and philanthropy. Instead, the social investor is deciding how to optimise a social investment portfolio based on their criteria. It has become another wealth deployment activity.

The theory of social investment realisation is that in order to become committed to using wealth for social investment a person needs to go through a process of realising that there is a new form of financial asset class. During the course of this realisation process the individual will feel confused as to whether a specific asset is an investment or philanthropy. The length of this period will depend on the individual and it may be dependent on how the social investment is presented, although the study does not have conclusions on how to affect this process as yet. Evidence for this process did not just exist from the different states of the participants in the interviews; it was present in the interviews themselves. During the interview many participants who were not existing social investors developed a degree of confusion during the course of thinking about the philanthropy/investment dilemma, particularly when discussing specific product concepts.

Knowing that this state of confusion is likely to occur is significant. In presenting social investments, it is important to present them as a new asset class. Potential social investors should be reassured that it is normal to have a period of confusion as to how to categorise social investments.

Understanding this realisation process can help those developing social investments to present them in a way that makes it easier for the potential investor to understand how they fit with the existing pots they have already allocated to investment and philanthropy.

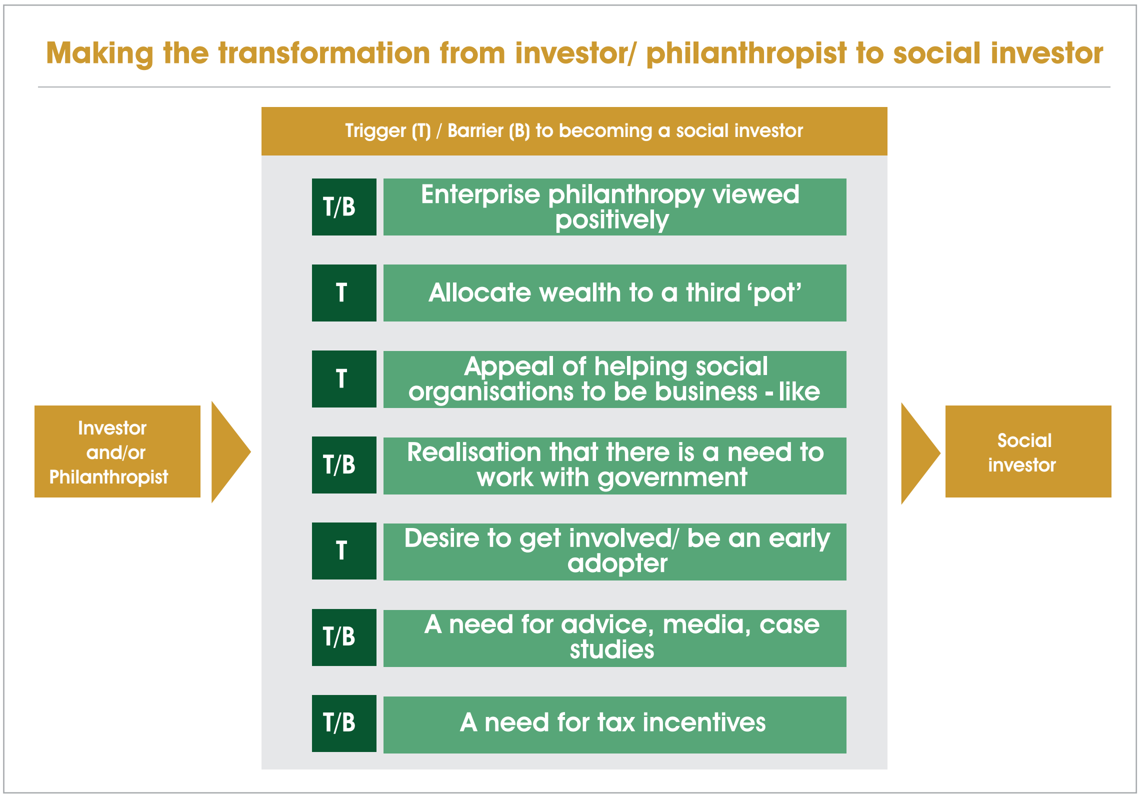
In presenting social investments, it is important to present them as a new asset class.

This theory begs a further question in that if the amount of wealth available for deployment cannot be expanded, from which pot is social investment drawn? Is less available in the investment pot or in the philanthropy pot? This question is not answered in this qualitative phase, although some indications may be drawn from the quantitative study that is in progress.

2.2 Triggers and barriers to becoming a social investor

This section describes triggers and barriers affecting the motivations of VHNWIs towards social investment. No conclusions are drawn at this stage as to relative importance other than that they were all strongly present in the interviews. In the short explanations that follow, initial consideration is given as to the underlying function or cause of the behaviour e.g. the individual is motivated to improve ***understanding*** of social investment.

Diagram 2: Triggers/barriers in the process of transforming from a investor/ philanthropist to social investor



A. Enterprise philanthropy viewed positively

Individuals can be motivated by a sense of achieving social objectives through receiving a sub-market investment return using an enterprise model rather than through gifts/aid. They can be convinced that the lower return is justified by achieving outcomes that would not be obtained through charitable donation. In addition, they recognise the leverage effect of investing/lending money with a view to recycling it.

The motivator appears to have a high element of ***nurturing society*** and a desire to see a social purpose achieved. The ability to re-cycle funds gives the interviewee a sense that the good effects can be multiplied through time.

The return on investment can also be a barrier since some interviewees were uncomfortable that they made any return or had the potential for significant gains on money used for a social purpose. There was particular concern if they were to make a substantial return on a social investment - as it caused a moral dilemma.

i

Individuals can be motivated by a sense of achieving social objectives through receiving a sub-market investment return.

“It's wanting to be convinced that the sub-market return is going somewhere useful”

B. Allocating wealth to a third "pot"

Having identified that there is a third use of their wealth, existing social investors are keen to find opportunities for further investment in order to achieve an allocation. The motivator appears to be ***goal-oriented*** (reflective, long-term thinking) linked with social investment becoming a ***habit*** (automatic actions). The interviewee has an expectation that more of his/her wealth will be allocated to this "pot" in the future. They are prepared to make an allocation of their total wealth in this area.

This points to a need for a variety of social investment products to be made available, in order to enable an individual who has reached this point to build a portfolio.

C. Appeal of helping social organisations to be business-like

Some interviewees view social investment as encouraging charities/social enterprises to be more efficient. Compared with philanthropy in the form of gifts, there was seen to be potential to encourage better stewardship of resources. The enterprise model was viewed as a good way of establishing a track record.

For some individuals this could result in social enterprise being preferable to charitable giving, for others it may be a motivator to transfer some of the investment "pot" into a social investment with business discipline.

The motivator appears to be the desire for a greater level of ***control*** to be present in the efficiency of these organisations. The interviewees sense that a greater level of control will produce more social outcome.

D. Realisation that there is a need to work with government

A trigger can be that social investment is seen to be filling a gap between what the government can provide and the social solutions that are needed. Investors realise that this may involve working with government to achieve a desired social outcome. The social investor recognises that individuals and communities have a role in investing in ***socially beneficial*** projects.

The barrier is that the social investment can be viewed as an alternative tax. Rather than filling a gap, it is providing services that would otherwise have been paid for through taxation. If a lower return is being received than for a comparable investment, this could be viewed as a form of voluntary taxation. In such an instance the social purpose of the investment impacts how it is viewed by a VHNWI.

Social investment is seen to be filling a gap between what the government can provide and the social solutions that are needed.

The fundamental barrier is a matter of ***trust*** that the government's involvement will not ultimately result in some form of detriment for the social investor. Examples of the detriment are a change in the "rules" relating to government contracts following a social investment commitment, or the discovery that the social good expected has not been delivered due to government action.

E. Desire to get involved / be an early adopter

For existing social investors one trigger that motivates is the need to create the market that encourages enterprise. There is an acknowledgement among early adopters that they need to "take a bit of pain" in order to develop the sector. The idea of being a catalyst is appealing to some.

This motivator will gradually reduce, but it may take some time before there is no sense of being an early adopter in the market. It may be possible to encourage others to participate if they feel that they will join the group of early adopters. A component of this motivation is the imitation of those who are setting the example.

F. A need for advice, media and case studies

Existing social investors have had to overcome a lack of advice and other information sources that would have given reassurance and comfort that a decision to invest is wise. They have needed to have the trigger of being an early adopter as described earlier. In order for more VHNWIs to engage with social investment, it will be important for social investment to be treated in a similar way to other advice on wealth. The perceived lack of developed methods of ***improving understanding*** is a barrier. There is an expectation that it is normal for major initiatives such as the development of a new financial asset class to be accompanied by extensive information, which needs to be met. This applies even if the initial focus was on high net worth individuals.

Existing social investors have had to overcome a lack of advice.

- *Advisors* – some interviewees wanted their financial advisors or banks to speak to them on this area. One interviewee went as far as to suggest that financial advisors should be required to bring the potential of investing in this area to the attention of clients.
- *Media and PR* - this helps potential investors to be better informed and to have a sense that the asset class is becoming normal for individuals in their wealth bracket. The issue was raised of publicising the experience of existing social investors and of encouraging wealthy trusted public figures to become involved.
- *Case studies* – these were viewed as a good way of helping to identify with social causes and to encourage others to get involved.

G. A need for tax incentives

Tax incentives were very widely discussed in the interviews, even with those who had made an investment without a tax incentive. The existing social investors frequently raised that it would be a motivator for them to continue to invest or that it was needed in order to grow the market.

Some viewed tax incentives as a way of emphasising the positive aspect of working with government to achieve social outcomes. The lack of a tax incentive appears to be a barrier in this area currently because there is an expectation that if social investment is to be encouraged in a similar way to other relatively risky business schemes, then a tax incentive is appropriate.

The lack of a tax incentive appears to be a barrier.

Four reasons for introducing a tax incentive follow, three are from the VHNWI population and the other is an important point in respect of the wider affluent population:

- *"Jump start"* – this would give an official endorsement to the activity. It is an effective way of "nudging" those interested into considering that it would be a normal action to allocate wealth to social investment.
- *Public awareness* – the act of providing a tax incentive would create significant public awareness. The government again would be providing a strong "nudge" by delivering a message that it considered social investment to be sufficiently important to provide an incentive.
- *Sharing the benefit* – it would give a sense that the social investor was sharing the cost/benefit with the government, which is seen by many as the primary provider of services to meet social needs.
- *Financial gain* – this study does not contain evidence on this point, but the incentive would need careful implementation. It will appeal to those that want to pay less tax. It may be appropriate for relatively wealthy individuals to encourage wealth into social investment. For less wealthy individuals (mass affluent) it may encourage investment without taking full account of the risk as a result of perceived government endorsement of a relatively new asset class. This point will be further considered in the more detailed report that will follow the quantitative study.

3. Further research

Quantitative research will gather insight into the motivations of the mass affluent in respect of social investment. This will give a comprehensive view of those that have investment assets between £50,000 and £1 million, excluding businesses and property. The survey will include detailed feedback on four specific social investment products, which have been extensively refined following the qualitative research.

The four products on which the respondents can comment are: a charity bond, a community business share issue, a social enterprise property fund and a social investment fund.

The research may give valuable input into the reaction to social investment by:

- *Population segment:* by age, income, value of investment assets
- *Attitudinal/motivational characteristics:* for example, link with charitable activity, views on business, views on government involvement
- *Incentives:* in particular, the perception of tax incentives in this context
- *Information requirements:* in particular, how would a prospective investor expect to acquire sufficient knowledge to make an investment.

In addition, it may be possible to comment on financial well-being. In particular, whether having a greater sense that an individual's wealth is being used for a social good could lead to a greater sense of well-being.

FURTHER INFORMATION

NESTA
1 Plough Place
London EC4A 1DE

e: research@nesta.org.uk
w: www.nesta.org.uk

ABOUT NESTA

NESTA is the UK's foremost independent expert on how innovation can solve some of the country's major economic and social challenges. Its work is enabled by an endowment, funded by the National Lottery, and it continues to operate at no cost to the taxpayer.

NESTA is a world leader in its field and carries out its work through a blend of experimental programmes, analytical research and investment in early-stage companies.