power to change

Financing the future economy:
How community businesses can access the right finance to achieve their ambitions

Jessica Craig

May 2024

Executive summary

This report draws on what Power to Change has learned from funding, supporting and advocating for community business since 2015 to provide an overview of the finance and funding landscape for community business. It points to the challenges community businesses face in accessing the right type of finance at the right time to achieve their ambitions. It highlights the range and complexity of the sources of finance used by community businesses to start up, grow and sustain their businesses, and the relative challenges and opportunities that these present. It also situates access to finance within the wider policy context and provides recommendations on how funders, investors and government at all levels can unlock finance for this vital sector to create a fairer and more sustainable economy.

Accessing finance is a major challenge for community business

Community businesses in England have a total annual income of just under £1 billion and typically operate a hybrid business model to finance the development and delivery of services and facilities. Grants plus commercial and trading income are the two largest sources of finance for community businesses, but beyond these income is derived from many different sources, thus forming a complex patchwork of funding.

As in the rest of the economy, the Covid-19 pandemic and the cost of living crisis have had a significant impact on community business income, while also raising operating costs and increasing demands for their services. This has knocked the financial confidence of community businesses, and accessing the right finance at the right time to support their ambitions is a major concern. In 2022, three in five (61%) community businesses said they wanted support to find and access sources of funding, and most ranked this as being the most important form of support that they needed.[1] These concerns are mirrored in the wider social enterprise sector. In 2021, less than half (44%) of social enterprises felt that the amount of external finance (such as from grants and loans) available to their organisation was sufficient. Newer organisations (established in the past three years) and those based outside London were even less likely to feel that the external finance available to them was sufficient.[2]

The ability to access the right forms of funding and financial support at the right time is a crucial part of the development of any business, and community businesses have readily identified funding as a key component of confidence and future business growth. For all community businesses, having a financially sustainable footing influences their confidence about the future, as well as their ability to withstand successive external challenges while continuing to strengthen their communities.[3]

1 CFE Research and Power to Change (2022). *Community Business Market Report 2022.* Available at: www.powertochange.org.uk/market-reports/market-report-2022/.

2 Darko, E. (2021). *No Going Back: State of Social Enterprise Survey 2021*, Social Enterprise UK. Available at: https://www.socialenterprise.org.uk/seuk-report/no-going-back-state-of-social-enterprise-survey-2021/.

3 CFE Research and Power to Change, *Community Business Market Report 2022.*

As this report demonstrates, the community business market is a diverse one, populated by many different types of enterprising organisations delivering social and economic impact for their local communities. This diversity often impacts how community businesses experience challenges around access to finance, with sector type and legal form being among the many factors influencing the modes of funding most readily available to them. This report also tells the story of a broader challenge among social purpose organisations: to have both their social value and economic potential recognised by those who fund them and those who create the policy environment in which they operate. Many of the challenges for community businesses highlighted in this report are also true for other types of trading grassroots community organisations and social enterprises. As such, the recommendations made here can also help create an enabling environment for the wider future economy – supporting those organisations that trade for purpose, not profit, to create a fairer and more sustainable economy.

The finance landscape is varied and complex, and each form of finance comes with its own challenges and opportunities

Community businesses spend a significant amount of time and resources on exploring different types of finance, understanding what is offered, and weighing up their relative merits. Different types of finance enable different activities, with some types best suited to capital purchases (such as buying an asset) or revenue expenditure (such as paying staff), while others offer community businesses more flexibility in how they spend to benefit their business. These factors also influence the impact and duration of a particular source of income on community business finance, from short to long term.

A range of different income sources, enabling communities to access the right type of finance at the right time, is necessary to the growth and development of community businesses. This report explores some of the major sources of finance available to community businesses, what they enable, and the challenges faced in accessing them.

Grants

There is a broad and sizeable landscape of grant funding available to community businesses. These range from small grants of £1,000 to multi-million-pound capital grants, and with varying terms and conditions of use set by grant funders. Community businesses receive grants from a range of sources, including trusts and foundations, National Lottery funds, and from central and local government. While grant funding is one of the most low-risk forms of finance, and is essential to community business development in the start-up period and at key stages of growth, it can also be challenging to navigate the complex grant funding landscape and the language and requirements involved. Securing grant funding may also be difficult due to high competition. Additionally, restrictions on grant use may be set by funders, and this lack of flexibility may prevent grants from being used to support the growth of revenue streams.

Enterprise grants

Innovations in enterprise grantmaking are helping to address the risk of grant dependency by using funding conditions and incentives to encourage organisations to build their capacity to earn income from trading. Enterprise grants help to create an entrepreneurial mindset and encourage financial sustainability among community businesses. They are often delivered alongside a cohort-based capacity-building programme, which increases the up-front cost of delivering enterprise grants for funders; however, evidence from enterprise grant programmes suggests that this combined funding plus support approach enhances organisational survivability and skills development.

Trading income

One of the key features of community businesses, when compared to many charities and other third-sector organisations, is that they are trading organisations and earn income from undertaking trading and commercial contracts across a range of activities, such as public-facing support services, operating venues, retail and hospitality, and arts and culture.[4] The income generated by these activities can be used flexibly to cover costs such as staff, rent and utilities, with any surplus used for reserves or repaying investors. As such, generating trading income is often a core activity of community business. However, it can take time to establish trading activity and increase revenue, and trading income can be vulnerable to external forces which increase costs and limit demand for goods and services.

Social investment

The UK social investment market is now valued at over £9.4 billion and provides repayable finance to help organisations achieve a social purpose. Community businesses have utilised loan finance and shares (particularly community shares) to purchase assets and build their income streams, enhancing their capacity to increase revenue and, in turn, repay their investors. However, there are well-documented barriers for community businesses in accessing social investment. The cost and short-term nature of loan finance remain significant challenges for many community businesses, who often operate in areas of high deprivation and at low margins. In addition there are non-financial barriers to social investment, such as the inaccessibility of the language around investment (which initiatives such as Good Finance have sought to address), and aversion to debt among smaller organisations.

Grant funding has been made available to help organisations achieve 'investment readiness' (such as the Reach Fund), while the terms of social investment can be softened to help organisations build their capacity to take on repayable finance.

Blended finance

Blended finance products combine social investment and grant funding to offer a mix of repayable and non-repayable finance. The aim of the grant element is to facilitate lending by subsidising costs or reducing the amount to be borrowed, and to leverage in investment capital by improving risk and return expectations. Blended finance can make social investment more accessible and less risky for community businesses, as well as reduce the perceived risk to investors of investing in organisations without a track record of repaying finance. Blended finance has supported a wide range of sectors and beneficiaries, and increased capital to smaller organisations and in lower socio-economic areas of England, resulting in more impact in these places. However,

4 CFE Research and Power to Change, *Community Business Market Report 2022.*

setting up blended funds requires the convening of social investors and funders (often more than one of each) and reaching a common set of strategic goals across all of these partners may be challenging, as each will likely have their own objectives to fulfil as part of the partnership.

Community shares

Community shares are a form of withdrawable, non-transferable equity investment particular to co-operatives and community benefit societies. They enable the local community to have a direct stake in a community business for a small amount of investment, and represent a form of affordable, patient capital, as shareholders prioritise the preservation of the community business and its assets over achieving a return on their investment. Community shares can leverage in additional finance for community businesses, often helping to attract more traditional grants and loans, and are being used to match-fund grants through the government's Community Ownership Fund.

Creating a community share offer may require specialist advice and technical support, and community businesses may benefit from grant funding during this period, such as from the Community Shares Booster Fund.

Private and commercial borrowing

Like other business types, community businesses can approach commercial lenders, such as mainstream high street banks, for secured or unsecured loans. Private and commercial borrowing can be more suitable for large asset-based purchases, or mortgages on property where the loan is secured. Borrowing from high street banks may appear to offer better interest rates than social investment; however, the risk calculations of commercial lenders are less likely to take account of the social value of community businesses. It can be difficult to secure a commercial loan without a history of earned income, meaning that this may not be suitable for organisations seeking funding to develop their revenue streams from trading.

There are many other sources of finance that community businesses access, ranging from the use of reserves, to crowdfunding, or borrowing from family and friends. While less is known about the take-up of other forms of finance, these can nonetheless be important sources of funds at crucial milestones in the development of a community business.

Other factors impacting on community businesses' access to finance

Asset purchase

The type of activity that community businesses are seeking to finance can also impact on the availability of that finance. Community assets can be essential to community businesses' service delivery capacity and their financial sustainability. Community businesses in England currently own fixed assets worth an estimated £744 million, and these are key to generating trading income. They also provide social infrastructure, create a sense of pride in place, and contribute to the local economy. Therefore, the financing of asset acquisition and development is an important aspect of the overall picture. A quarter of assets come into community ownership through a community asset transfer, while an additional 24% are donated at no cost or peppercorn rent.[5] However, community businesses still need to source finance to set up, manage and maintain their assets in order to be able to generate an income stream from them. Asset purchase can be funded in different ways, including grants, social investment and blended funds, commercial loans or community shares.

But community businesses often struggle to access capital at a scale and pace to compete with private investors. They may lack the skills needed to navigate the commercial property market, and may be prevented from unlocking vacant and underutilised property for community benefit due to the opaque nature of property ownership.[6] These are challenges that Power to Change has sought to address in its history as a funder, as well as through ongoing advocacy for the extension of the Community Ownership Fund and introduction of a British High Street Investment Vehicle.

Among more mature community businesses there exists a growing network of asset-developing community businesses who are activating and stewarding land and buildings in their neighbourhoods. The funding required to enable this type of transformative work differs significantly from the finance required for early-stage and developing community businesses, and the more established community businesses involved are working to unlock sufficiently large-scale and long-term investment that is aligned to the needs of more mature asset-owning community businesses, to grow and sustain their neighbourhood-wide impact.

Changes across the life cycle of community businesses

The need for finance varies at the different stages of development in the life cycle of a community business. Requirements in the very early stages, when local people first become aware of the need for a community business, are very different to those of a more mature organisation that has reached the point of scaling up. At the very earliest or pre-venture stage, businesses may not be eligible for finance until they begin trading. Micro, flexible and small-scale grants can be effective as a community business starts up, helping to pay for the external expertise needed to establish and develop its business model, as well as in starting to generate revenue.

Beyond these two initial stages, and whilst trading is still in its infancy, access to the right kind of finance to enable growth can become a major challenge. Community businesses at the growth stage struggle to increase revenue and they need flexibility to adjust their plans and develop ideas. When a community business reaches a sustainable position, having finance to buy capital equipment or to sustain core activity for long enough to develop areas of their business can help them to scale up, but funding at this stage remains insufficient and too short-term in nature.

Access to the right forms of finance to achieve their ambitions throughout their life cycle is vital to ensuring community businesses can grow, scale and sustain their impact for their local community, over the long term.

5 CFE Research and Power to Change, *Community Business Market Report 2022.*

6 Plumb, N. (2022). *Why now is the time for a High Street Buyout Fund*, Power to Change. Available at: https://www.powertochange.org.uk/news/why-now-is-the-time-for-a-high-street-buyout-fund/#.

Challenges for marginalised community businesses

Persistent underinvestment in community businesses led by and supporting people experiencing marginalisation, combined with the impact of austerity measures and increased demand on overstretched services, has left many community businesses struggling with financial sustainability.[7] The challenges in accessing finance for marginalised community businesses might range from eligibility requirements around their legal model and governance structure, having to demonstrate a 'track record' of delivery, or the complex application forms and inaccessible language used by funders.

The policy picture

Government, at all levels, has an important role to play in shaping the conditions in which community business can access the right funding at the right time to achieve their ambitions. As the impact of austerity continues to worsen the financial position of local authorities, the role of a strong community business sector in meeting local needs has become ever more important. But beyond filling service gaps, investing in the community business sector gives people a greater voice in what happens in their local area, and local and regional authorities are recognising the potential of community business to sustainably deliver local economic development by keeping the opportunities, assets and wealth they create in the hands of local people.

Throughout much of the 2010s, central government interventions were focused on unlocking finance for community business by incentivising social investment, but since 2019 levelling up-related funding pots have seen capital flow directly and indirectly (via local and combined authorities) to community business. Added to this, recent high streets policy initiatives have recognised the role for communities as partners in developing and delivering on local visions for growth. With an election approaching, the Labour Party has also begun to set out its approach to financing the sector. Labour's emerging industrial strategy demonstrates the critical role for community businesses and social enterprises in delivering the party's mission, while its commitment to delivering clean power will not be achieved without significant investment in community-owned energy.

The need to finance and support community business is clearly integral to the achievement of both major parties' political agendas, and to creating the more inclusive and sustainable local economies that many local authorities strive to build. But despite these positive signs of recognition, community businesses are often overlooked as economic actors and they are not backed in the same way as traditional businesses, with subsidies and support to attract further investment.

7 Sparks Insight and Locality (2023). *Exploring Barriers to Funding and Support Experienced by Marginalised Community Businesses Insights: Solutions and recommendations for funding and infrastructure organisations*, Power to Change. Available at: https://www.powertochange.org.uk/research/exploring-barriers-to-funding-and-support-experienced-by-marginalised-community-businesses/.

Policy recommendations

Community businesses need access to a range of different sources of finance to meet their needs at different stages of development and to support different activities (such as asset ownership, or income diversification). Accessing the right forms of finance at the right time is essential to their ability to deliver for their communities, sustainably and for the long term.

Recommendations for funders and social investors

Funders and social investors can play a key role in enabling access to finance for more community businesses by addressing the challenges and barriers outlined here, working to create a more accessible and affordable finance landscape, and supporting community businesses to diversify their income streams.

Funders and social investors should:

1. **Ensure grant funding supports community businesses to diversify their income streams and reduce grant dependency.**

Grant funding should support community businesses who want to develop and diversify their income streams and increase the resilience of their business models. Funders should harness innovative approaches, such as enterprise grantmaking, to help more community businesses to earn income from trading and to foster long-term resilience. They should also provide funding and support to enable community businesses to access social investment, such as through blended finance, or investment from the local community through community shares.

2. **Enable greater equity in access to funding, and fund flexibly to help community businesses meet their needs.**

Funders can take practical steps to reduce the complexity of their language and application processes: using plain English and avoiding jargon, shortening application processes, limiting questions and documentation required, and providing application support to prospective grantees. All of these steps could help to reduce the time and resource burden faced by community businesses and empower organisations that are typically underrepresented to access funding.

Funders should also be driven by the needs of the sector rather than their own priorities and should fund as flexibly as possible. Unrestricted funding shows that funders trust community businesses to know where the greatest need is, within their business and their local community, and how to respond to it.

3 Provide affordable, transparent and long-term investment that works for community business.

Social investors should offer affordable, transparent and long-term investment that matches the ambitions of community businesses and their current realities. This includes ensuring interest rates offered on social investment are genuinely affordable, and using products such as blended finance or small grants to support 'investment readiness'. Such mechanisms help community businesses to build the capabilities, financial resources and confidence to begin taking on repayable capital. Social investors should also consider how adopting innovative approaches that recognise the 'double dividend' of community businesses and social enterprises (their combined social and economic value) could increase take-up of social investment – such as Kindred's approach to enabling partial repayment of small, early-stage loans in social return.

To achieve this, social investors will in turn require access to sufficiently large-scale and long-term concessionary finance that enables them to fund patiently, flexibly and affordably. Dormant assets funding is supporting the growth of the blended finance market, but more work is needed to unlock concessionary capital, by government and beyond.

Recommendations for government

Government, at all levels, also has a role to play in unlocking access to finance for community businesses. Central government should continue to support community business through public funding tailored to local communities, such as the Community Ownership Fund, as well as by unlocking other sources of finance to be administered to communities, for example through the dormant assets scheme. Government should also make better use of public funding to leverage in greater private investment in community businesses and the social economy through tax incentives. Local and regional government can also support community businesses through their efforts to build fairer and more prosperous local economies. They should also take advantage of the opportunity of devolution to pass on place-based investment (for example, from levelling up funds) to the accountable and impactful community-led organisations who can build stronger communities and better places.

The next government should:

1 Adopt a cross-governmental strategy for the social economy.

The next government should adopt a social economy strategy to fundamentally reshape the approach to growing and developing this high-potential sector of the UK economy. A role within the Cabinet Office with responsibility for coordinating cross-governmental commitment to resource, empower and grow the social economy would finally give community businesses and social enterprises the policy attention and coherence that they deserve, and which is required to meet the challenges they are facing.

2 Introduce a successor to Social Investment Tax Relief.

To help community businesses to thrive, the next government should work with the social enterprise sector and social investors to test and develop new incentives to investment in the social economy, including a successor to Social Investment Tax Relief (SITR). A successor scheme should learn from and address the challenges of SITR, including by reducing the burden of accessing tax relief, and by expanding eligibility to include a wider range of legal models and venture types (including community-led housing and community energy).

3 Use dormant assets to provide long-term, flexible investment in community business.

As funding which sits outside of the usual constraints of Treasury fiscal rules, dormant assets funding can be a valuable source of capital to meet the need for flexible, long-term investment in community business. The quantum of funds must reflect the scale of their ambition, and Government should continue to make the case to financial institutions for dormant assets to provide patient and flexible capital, and continue to expand the scheme.

4 Unlock more private and institutional investment in community business.

Government should also explore how it could unlock more institutional capital for organisations that typically struggle to access finance through Community Development Financial Institutions. This could include pension fund reform or unlocking more investment from commercial banks through reforms akin to the US Community Reinvestment Act.

5 Continue to fund and support community asset ownership.

The next government should facilitate more community asset ownership by committing to the continuation of the Community Ownership Fund in the next Parliament, including through the ringfencing of any underspend of the current fund for community ownership activity.

Local and combined authorities should:

1 Empower community businesses and other social purpose businesses as part of an inclusive growth approach.

Community business has an important role to play in creating fairer, more inclusive local economies. Committing to an inclusive growth approach to local economic development is an important first step for local and combined authorities in establishing partnerships and embedding a commitment to nurture the growth of community businesses and other organisations in the local social economy.

2 Use the opportunities of devolution to formalise support for community business and unlock access to funding for the social economy.

Local and combined authorities should ensure a cabinet or strategic board member has explicit responsibility for growing and supporting the social economy, thus providing opportunities for accountability and sustained partnership working between local government and the sector. These commitments should be reflected and resourced as part of any devolution deals and financial settlements with central government.

3 Act as a convenor in place and leverage additional investment in community business, community-owned assets, and the local social economy.

Local and combined authorities should also act as convenors in their place, leveraging their own investment in the sector to incentivise other local organisations, funders and investors to provide access to finance for community businesses in their locality.

Power to Change
The Clarence Centre
6 St George's Circus
London SE1 6FE

020 3857 7270

info@powertochange.org.uk

powertochange.org.uk

@peoplesbiz

Registered charity no. 1159982

COMMUNITY FUND

Power to Change is the think-do tank that backs community business. We turn bold ideas into action so communities have the power to change what matters to them.