

# Impact Investing in the Cultural and Creative Sectors

Insights from an emerging field

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The origin of this research collaboration was ongoing dialogue between Maggs and Sanderson on the health of CCS organisations in post-pandemic economies and the need for more confident and creative approaches to resourcing creativity and cultural production and registering its value as a social benefit sector more broadly.

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# Executive summary

**This report explores how the emerging field of impact investment presents a valuable tool for realising the potential of the cultural and creative sectors (CCS). It is aimed at a broad and diverse group of stakeholders – including cultural and creative sector organisations and practitioners, private and public cultural funders, investors and policy makers – illustrating their overlapping interests and the opportunities for collaboration.**

We define impact investing as the provision of capital, typically to incorporated enterprises, with the aim of achieving both a financial and social return. Impact investors proactively seek investment opportunities that will make an intentional positive difference.

CCS organisations bring diverse and rich social benefits. Social impact in the cultural and creative sectors can cut across many different kinds of activity – from the core artistic or creative form to ancillary community outreach projects – and across many different policy areas, such as health & wellbeing, education, criminal justice, placemaking and economic growth. A growing number of working groups and an increasing evidence base are supporting policymakers and funders to incorporate the CCS into decision-making.

At the same time, caution needs to be exercised regarding the potential for outcome measurements to be reductive, with recognition that the systems of value of the arts are complex and interdependent.

Impact investment is a growing market, with the Global Impact Investing Network estimating the market size as US\$1.164 trillion in 2022. In the UK alone, the market has seen more than tenfold growth over the past 11 years, increasing from £830m in 2011 to almost £9.4 billion in 2022 according to data from Big Society Capital, the UK's provider of wholesale impact capital.

At the moment, impact investment predominantly comes from charitable trusts and foundations, government agencies, and high net worth individuals and family offices, often through intermediaries such as fund managers that can help bridge the gap between investors and frontline social enterprises. Interest in impact from institutional investors is growing rapidly, and allocations towards impact investments reflect this.

In order to attract more constrained or tentative investors with different risk tolerances and less direct experience of investing in the CCS, blended capital structures use concessionary funds to derisk the market for new entrants. These may take the form of grants or first loss equity, and often represent a superior return profile to a standard grant (because some of the funds will be returned to the provider), even before considering the additional benefit of growing the market, attracting a more diverse investor pool and building the universe of case studies. The availability of such 'concessionary capital' is therefore significantly catalytic to market development, including making sure more flexible and risk-tolerant investment products can be extended to organisations in need of finance.

New funder and investor relationships in support of CCS organisations will help them to develop new business and impact models and new creative and cultural assets; to

attract and retain audiences while adapting to changing audience behaviours; to navigate risks and opportunities brought about by new technologies, and enable artists to participate equitably in the success of their work. At the same time, a diverse array of assets, both tangible and intangible, as well as an appetite to develop new venture models, mean the sectors offer serious investment potential.

For CCS organisations, impact investment has the potential to introduce new, affordable, patient and flexible capital, through capital leverage and recycling, while also stimulating new mindsets and behaviours around innovation and long-term thinking.

Impact investment in the CCS is an emerging field with a diverse range of initiatives around the world. The international Creativity, Culture & Capital project<sup>1</sup> has made a start at identifying and highlighting impact initiatives in the global creative economy and the funding models used to support them, including New York-based Upstart Co-Lab, researching the potential of and connecting impact investment to the creative economy in the United States; and HEVA in Kenya, building the creative economy innovation and funding ecosystem across East Africa. A comprehensive mapping of global initiatives in this space would be a welcome addition to the literature.

The report provides an in-depth case study of the Arts & Culture Finance initiative in the UK, which was incubated by the innovation agency Nesta between 2015 and 2023. Arts & Culture

Finance manages three impact investment funds that have supported 51 CCS organisations in the UK, majority non-profit, with £14.6 million of investment since 2015. The case study illustrates a broad range of impact delivered by investees as well as their significant ambitions to grow and develop new activities.

Preliminary findings from the Arts & Culture Finance case study indicate that a blended capital model of debt-based impact investment in the CCS can succeed in delivering expected returns to investors. The case study, which spans the Covid-19 pandemic, also illustrates the need for funders and intermediaries to take a flexible and long-term view of the underlying portfolios, in response to the challenges both the macro environment and idiosyncratic organisation-level issues can pose.

While a formal evaluation of the ongoing ACF programme has not yet taken place, evidence suggests that investments from Arts & Culture Finance have helped portfolio CCS organisations to achieve their business, financial and impact-related objectives, while also contributing to improved financial resilience.

In its Global Agenda, the Creative Industries Policy & Evidence Centre highlighted the need for a coordinated approach for the development of alternative finance models, and impact investing in particular<sup>2</sup>. An international coalition should work towards making the case for the establishment of a global fund, or pooled capital vehicle, focused exclusively on the CCS, or the broader creative economy.

**In order to create the conditions for a flourishing impact investment infrastructure for the CCS at the national level, policymakers and other national stakeholders need to:**

- raise awareness of impact investment and the possibilities it presents to invest in and develop CCS assets;
- illustrate how impact investment can work in practice for both investors and investees;
- undertake stakeholder mapping and convening exercises;
- explore possibilities for fund structuring and the role for possible intermediaries; understand demand side factors (pipeline of eligible CCS organisations, their capital needs and degree of investment readiness);
- map the possible impact of the investment approach;
- understand what policy measures can be supportive.

# Introduction

**In this report, we aim to introduce the emergent practice of social impact investment (henceforth referred to as impact investing/ment) in the cultural and creative sectors (CCS). We will outline the opportunity this growing field of investment presents to redouble the potential of cultural and creative assets<sup>3</sup> in the UK and internationally.**

The report follows the 2014 Nesta report *The New Art of Finance*<sup>4</sup>, which identified resource challenges facing the cultural sectors, and also highlighted opportunities for action, including the development of an arts impact fund, and public facing R&D programmes supporting structured experimentation and shared learning. A decade later, the challenges not only persist but are exacerbated by more recent events such as the Covid-19 pandemic, cost-of-living crisis, persistent declines in available grant funding, and continued shifts in audience behaviour.

The broader impact investing landscape, in contrast, has developed significantly since 2014, with the UK continuing to be an international leader. Indeed, in such a rapidly evolving field, there is some urgency to establishing the cultural and creative sectors as a natural and productive home for the rising tide of capital actively seeking positive social impact. In 2015, Nesta, on behalf of a founding partnership<sup>5</sup>, launched the arts impact fund initiative outlined in *The New Art of Finance*. Significant levels of international interest in and engagement with the fund's development have highlighted a burgeoning global interest in how impact investing can support the cultural and creative sectors in particular.

With this document, we propose that impact investment is a valuable tool for realising the full impact potential of the cultural and creative sectors. We support this view with research, field interviews and proprietary data from Arts & Culture Finance, a specialist creative and cultural sector investment intermediary incubated by Nesta since 2015.

We see the relationship between impact investing and cultural and creative sectors (CCS – we are using 'cultural and creative' to capture the broad spread of industries and 'sectors' to capture the broad spread of organisation types, i.e., including non-profits and social enterprises as well as commercial entities) as relevant to a very broad international audience, including (but not limited to):

- CCS organisations and practitioners.
- Public arts and culture funders.
- Policymakers.
- Trusts and foundations.
- High net worth individuals.
- Institutional investors making or thinking about impact.
- Impact investment intermediaries, either already operating in or considering the CCS.
- Impact investment wholesalers and advocacy bodies, with a remit to support the development of a vibrant impact investment market/ecosystem/infrastructure.
- Social/cultural innovation specialists looking for capital to scale successful interventions outside a commercial funding framework.

We illustrate the overlapping interests of these stakeholders, and the exciting opportunities for collaboration and innovation to ensure a vibrant future for the CCS and the powerful positive impacts they deliver.

We also believe that impact investment as a tool has the potential to strengthen the connective tissue between subsidised culture and the commercial creative industries by encouraging adoption of different legal forms, prototyping new investment tools, and supporting the development of new partnership and collaboration models.

There is growing interest in the intersection of these fields, with significant high-profile impact investment events and gatherings now featuring sessions focused on the CCS, such as the European Venture Philanthropy Association (EVPA) Impact Week 2022, Global Impact Investing Network (GIIN) Investor Council, Big Society Capital (BSC) and the European Bank for Reconstruction and Development's (EBRD) Blended Finance event in March 2023<sup>6</sup>, and the Global Steering Group for Impact Investment Summits<sup>7</sup> in 2021-2023. At the same time, CCS events globally are featuring sessions on impact investment, such as the World Conference on the Creative Economy in Dubai in 2021, the British Council's International Policy Forum in Istanbul in 2022, the International Society for the Performing

Arts Congress in New York in 2022, and the Arts and Humanities Research Council's Beyond Conference in London in 2023. The Creative Industries Policy and Evidence Centre highlighted impact investment as one of eleven key actions in its Global Agenda for Cultural and Creative Industries in 2021<sup>8</sup>.

This report hopes to continue and support this momentum, serving as a catalyst to the establishment of national and international interest groups and communities of practice with representation from the broad range of interested parties listed above. These communities will provide a necessary supportive foundation for a mutually beneficial intersection between the impact investment and cultural and creative sectors.

Success in this regard will be measured by:

- accelerating capital flows into the cultural and creative sectors.
- a strong and growing impact investment infrastructure/ecosystem.
- and a growing evidence base around positive social impact.

**This report is structured as follows:**

## **1 The social impact of the cultural and creative sectors**

An introduction to the possibilities for social impact in the cultural and creative sectors.

## **2 Impact investing**

An introduction to the growing impact investment industry and developing practice.

## **3 The opportunity for impact investing in the cultural and creative sectors**

A discussion of the advantages to the cultural and creative sectors of having this growing source of socially conscious capital.

## **4 How impact investment can work in the cultural and creative sectors**

Some examples of how impact investment capital is being connected to the cultural and creative sector globally, with a particular focus on Arts & Culture Finance<sup>9</sup>, an initiative in the UK originated within innovation foundation Nesta<sup>10</sup>, in partnership with Arts Council England, Esmée Fairbairn Foundation and Bank of America<sup>11</sup>.

## **5 Creating the conditions**

A set of recommendations for how to create the conditions for a functioning impact investment initiative in the cultural and creative sectors.

1

# The social impact of the cultural and creative sectors

There is huge diversity and richness to the benefits brought about by CCS organisations and therefore many different ways to think about their social impact. Arts, culture and creativity are broad concepts incorporating many ideas and activities; they are complex by definition. This presents both challenges and opportunities. Challenges can arise, for example, when discussions of value and impact in CCS struggle to find a common language. On the other hand, this plurality means that the benefits of culture can be seen and felt in many different ways and by many different beneficiary groups.

Social impact in the CCS can, and often does, cut across different kinds of activity; music programmes in prisons; drama groups for victims of domestic violence; a riot sparked by innovation in musical composition;<sup>12</sup> a novel transforming an individual's outlook on life – and in order to account for it fully, interested parties need to look more deeply at the work organisations deliver. The cultural and creative sectors deliver positive impact in a vast array of areas, from climate to conflict, and migration to criminal justice; a comprehensive representation is beyond the scope of this report. The range of organisation types represented in the CCS is also important: while some organisations may naturally be more social impact inclined and accountable due to their constitutional objectives, legal structure, regulatory requirements or funding mix, every organisation has the potential to create value beyond the purely commercial sphere.

It is common to use the terms 'intrinsic' and 'instrumental' to talk about the value of the arts, broader culture, and creative pursuits – having 'intrinsic' value meaning something is 'desirable in and of itself', while things are deemed to be of 'instrumental' value if they help achieve a particular end (e.g., reduced falls through dancing classes<sup>13</sup>; relief of post-natal depression symptoms through singing<sup>14</sup>).

This is appealing as a dichotomy, but it can be hard to know where to draw the line; indeed, it isn't obvious that the 'intrinsic' and 'instrumental' values of a particular artistic endeavour are either mutually exclusive (implying they don't overlap) or collectively exhaustive (implying they capture between them the entirety of value), and they could be argued to be causally linked, i.e., the instrumental value occurs as a result of the intrinsic value, and often, for example in the case of artistic social practice, vice versa<sup>15</sup>.

Considering the challenges of this framework for understanding value helps us understand why we need to be cautious about reductive outcome measurements, and careful to consider systems of value of the arts as complex and interdependent.



## Social impact – developing an evidence base

### Using existing outcomes metrics

Notwithstanding the challenges and limitations of measurement, the CCS have increasingly needed to make a case for themselves beyond the intangible 'common good'. Over the last few years, significant and successful efforts have been made to establish and evidence the positive impact of flourishing, accessible and inclusive cultural and creative sectors, mapping it onto accepted measures of recognised positive social outcomes such as improved health and wellbeing or educational performance, or a reduction in recidivism. This has resulted in a growing evidence base and a nascent understanding of the hugely powerful contribution the sector can make to the experience of individuals, communities, society and the planet.

For example, in arts and health, the evidence on and interest in positive impact has developed significantly, from the 2017 publication of the All-Party Parliamentary Group on Arts for Health and Wellbeing enquiry report<sup>16</sup> to the Social BioBehavioural team at UCL's 2023 investigation of the impact of arts engagement on population health<sup>17</sup>. R&D in this area has seen increased interest from funding and research bodies<sup>18</sup>, and in the UK organisations such as the Culture, Health and Wellbeing Alliance and the National Academy for Social Prescribing, launched in 2019. A review of the evidence base for arts and health is provided by the team at University College London, led by Dr Daisy Fancourt<sup>19</sup>.

In terms of representing the full value of assets in cultural and creative sectors and organisations, there are ongoing efforts to recognise and measure these in economic terms (e.g., the UK Department for Culture, Media and Sport's Culture and Heritage Capital<sup>20</sup> framework), thereby allowing comparison with the value of other public assets. The case study bank of the Calouste Gulbenkian Foundation's Inquiry into the Civic

Role of Arts Organisations<sup>21</sup> provides powerful examples of the vital social role performed by arts and culture organisations, both nationally and within their local communities.

The notion that the intersection between arts and social impact is an area deserving of rigorous interrogation and specialised, intentional investment is thus gathering momentum, and reaping rewards. The Centre for Cultural Value, launched in the wake of the UK's Arts and Humanities Research Council's 2012 Cultural Value Project<sup>22</sup>, is a national research centre based at the University of Leeds, working alongside cultural practitioners, organisations, academics, funders and policymakers to: summarise existing evidence to make relevant research more accessible; convene discussions around questions of cultural value; shape policy development, and offer funding for research partnerships.

### Sustainable development: Mapping onto the goals

The contribution that culture and creativity can make to the United Nations' Sustainable Development Goals (SDGs), perhaps the most commonly recognised international framework for understanding social impact, is illustrated in the 2020 report *The Missing Pillar*<sup>23</sup>. This was commissioned by the British Council, and uses their funded projects to highlight how cultural and creative organisations have generated progress towards the SDGs. In 2019, in recognition of the power the CCS have to contribute to the achievement of the goals, the UN General Assembly declared 2021 the International Year of the Creative Economy for Sustainable Development<sup>24</sup>. For the purposes of this report, the 'creative economy' comprises the whole creative industries workforce (creative and non-creative occupations), as well as those working in creative occupations in other sectors<sup>25</sup>.

## Local, regional, national and international economic growth

The creative industries are a global success story for Great Britain, growing at more than 1.5 times the rate of the wider economy over the past decade and contributing £108 billion in gross value added (GVA) annually. Employment in these industries has grown at five times the rate of the rest of the economy since 2011<sup>26</sup>. In June 2023, the UK government released a Creative Industries Sector Vision<sup>27</sup>, developed with industry via the Creative Industries Council, setting out shared ambitions to build on that success and maximise the growth of the creative industries by £50 billion by 2030, creating one million extra jobs and delivering a creative careers promise that builds a pipeline of future talent.

The potential of these sectors to lead through innovation and contribute meaningfully to economic growth is reflected in the establishment of EIT Culture & Creativity<sup>28</sup>, a Knowledge and Innovation Community designed to strengthen and transform Europe's CCS by connecting creatives and organisations to Europe's largest innovation network.

The Creative Industries Clusters programme in the UK, launched by the Arts and Humanities Research Council in 2018, has delivered a 4:1 return on investment for the government<sup>29</sup> and boosted local economic growth, employment prospects and skills development opportunities. The generative effect of co-located or proximate development of creative

industries initiatives is also recognised by the recently announced 'Connecting Creative Corridors' enquiry, a national partnership between Arts Council England, the RSA and the Creative Industries PEC<sup>30</sup>.

The power of arts and culture to deliver local economic growth via increased tourism and footfall is reflected in the 'City of Culture' phenomenon. Other large-scale cultural events regularly demonstrate the power of arts and culture to deliver at least short-term economic growth via increased tourism and footfall, and regular events such as Adelaide Fringe<sup>31</sup> are delivering structural growth in local economies.

Internationally, the cultural and creative sectors are among the fastest growing in the world. According to UNESCO, with an estimated aggregate worth of US\$4.3 trillion per year<sup>32</sup>, the CCS now account for 3.1% of the global GDP, and 6.2% of all employment<sup>33</sup>, generating annual revenues of US\$2,250 billion and nearly 30 million jobs worldwide, and employing more people aged 15 to 29 than any other sector. The CCS has become essential for inclusive economic growth, reducing inequalities and achieving the goals set out in the 2030 Sustainable Development Agenda. The cultural sector and the commercial creative sector have deep symbioses, from inspiration to skills development, and the existence of a vibrant cultural infrastructure and creative education are vital for this continued growth.

## Capturing the value

Funders who take as axiomatic the intrinsic benefits to society of a thriving arts, culture and creative sector, such as public arts funders or trusts and foundations with support of the arts as one of their charitable objectives, may have found it easier to make early impact investments in the arts than investors accustomed to sectors with more generally accepted outcome metrics, such as health or education, or key development outcome metrics such as local and national economic growth and job creation.

A challenge arises in trying to strike a balance between top-down imposition of outcome metrics that may not fit a CCS initiative or intervention exactly (either because they are imported from a different sector or because an intervention is bespoke and/or delivers diffuse benefits across multiple outcome areas) and/or may capture only one aspect of value, and using bottom-up, bespoke measures, which can complicate the task of aggregating impact across a portfolio of investments in a meaningful way.

## 2

# Impact investing

**As an emergent field, there are many overlapping definitions and explanations of impact investing across the expanding literature. We intend simply to provide a coherent overview sufficient to develop a basic understanding.**

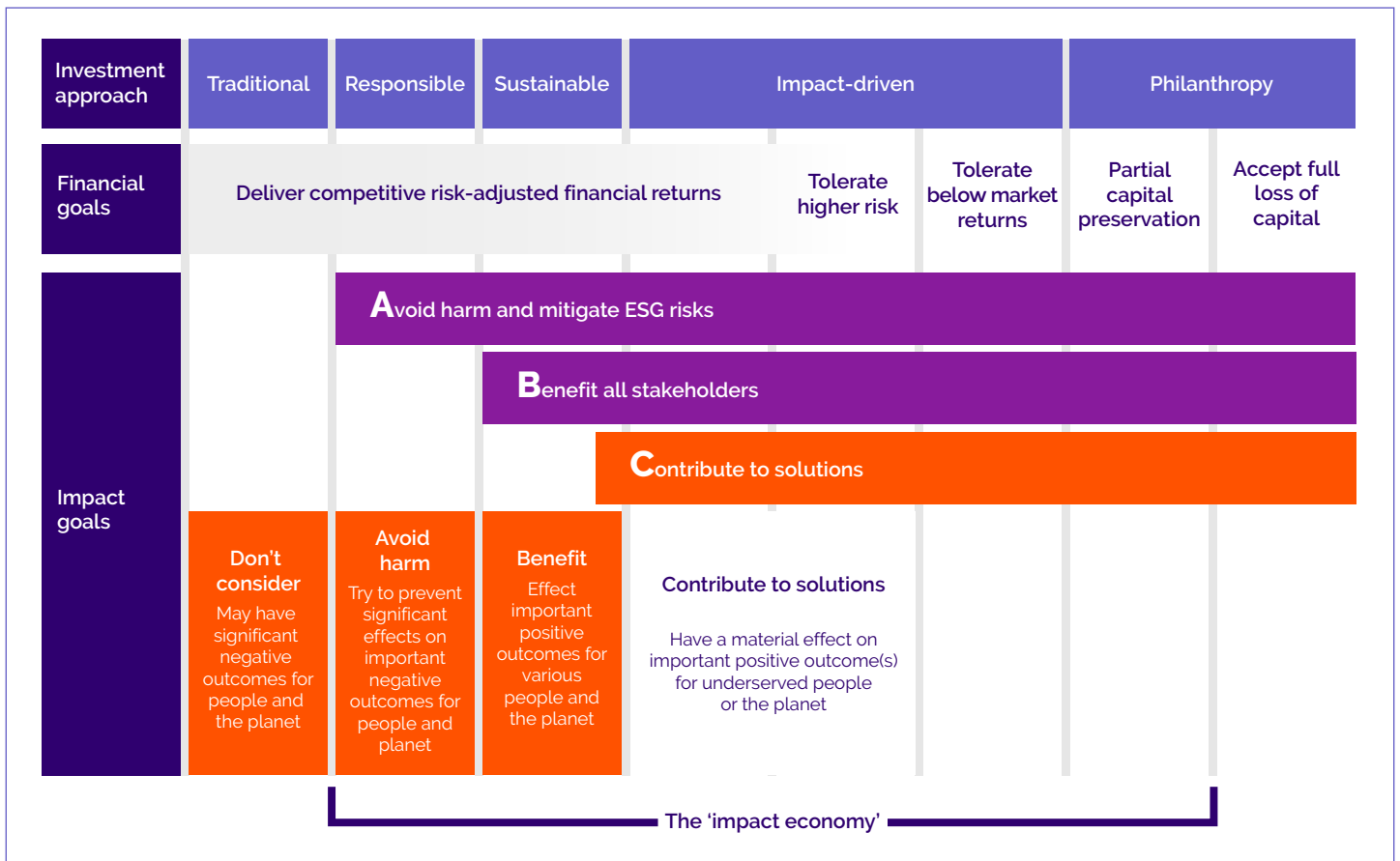
**“Impact investing is not a thing – it’s a lot of things. Whether you are talking equity in early-stage social ventures where you are willing to take risk in anticipation of reward, or something more like venture philanthropy, where the spirit remains philanthropic while the approaches borrow from the private sector, ultimately there are a lot of very different tools inside the impact investing toolbox. You need to know what you want to do before you pick one of them up.”**

Karim Harji, Programme Director, Oxford Impact Measurement Programme, Saïd Business School, University of Oxford<sup>34</sup>

Impact investing is the provision of capital, typically to incorporated enterprises, with the aim of achieving both a financial and social return. The intention to achieve demonstrable positive change alongside the aim of generating a financial return is the defining feature of impact investment: impact investors proactively seek investment opportunities that will make a positive difference. This positive change can be referenced in terms of ‘measurable outcomes’ – this is a key

distinction between financial return and social return, as the financial return is its own evidence<sup>35</sup>. However, given an increased focus on the potential negative outcomes associated with investments in the broader investment market, social and financial risks and returns are becoming more interlinked, as, for example, the campaign to move towards impact-weighted accounting standards<sup>36</sup> gathers momentum.

## The spectrum of capital<sup>37</sup>



As the impact investment market and its players grow in sophistication, breadth, diversity and imagination, we envisage that the appetite for experimentation and risk-taking around social impact delivery will grow, enabling the market itself to contribute both to the impact delivered by the sector and the evidence base around that impact. Impact investors who overlook the cultural and

creative sectors in their investment universe could begin to observe that their portfolios are missing an element that can deliver impact in its own right (e.g., social cohesion, overall population wellbeing) and can also contribute to outcomes typically measured separately (e.g., educational attainment, mental health, physical health, economic growth and development).

## The impact investment market

The field of impact investing is emerging through an exciting range of experimentation across numerous sectors concerned with social benefit – health, education, technology, sustainability, equity, accessibility and social justice. As with any emergent field, there are live debates around definitions. By any definition, though, the growth in the impact investment market over the last ten years outpaces that of the vast majority of other asset classes<sup>38</sup>. In 2022, the Global Impact Investing Network estimated the market size as US\$1.164 trillion<sup>39</sup>, up from US\$715 billion in 2020. The International Finance Corporation's 2020 global estimate<sup>40</sup> was even higher – US\$2.3 trillion, of which US\$636 billion clearly has an impact management system in place. In the UK alone, Big Society Capital's market sizing exercise for 2022 revealed more than tenfold growth over the past 11 years, increasing from £830 million in 2011 to almost £9.4 billion<sup>41</sup>.

Impact investment typically comes from high-net-worth individuals (HNWI)/family offices, charitable trusts and foundations, and government agencies, often through intermediaries such as fund managers (see below)<sup>42, 43</sup>.

Investments are typically made through debt or equity instruments; the UK market is largely debt-dominated, with equity or 'impact venture' investment making up only 7% of the market in 2022<sup>44</sup>. Crucially, the assessment of investee impact (impact returns) usually forms a key part of the deal-making process, in addition to traditional financial analysis, while reporting to investors and intermediaries includes information on both financial and social performance.

## Intermediation

Impact investments can be made directly by capital owners or, more commonly, via intermediaries. Typical advantages of using investment intermediaries can include:

### For investors:

- Specialist sector knowledge
- Networks and expertise
- Access to investment opportunities
- Portfolio management
- Risk management/diversification
- Economies of scale resulting in lower overall transaction costs
- Improved liquidity due to capital pooling vehicles

### For investees:

- Efficient access to investment capital
- More standardised terms and processes
- Specialised support on financial management
- Access to technical assistance

### On top of these, impact investment intermediaries will typically provide:

- Skills in pre-investment impact assessment
- Skills in post-investment impact monitoring and evaluation
- Knowledge of good impact practice
- Impact management and reporting advice and support to investees

Another critical role of the intermediary is to distribute and mitigate the fundamental power imbalance between funder and funded organisation, particularly when the intermediary represents a collective of underlying investors. The intermediary adds another cost into the ecosystem, usually in the form of fees. This will tend to increase the cost of capital to the recipient of investment.

## Fund structuring and blended capital

Where impact investment is intermediated, the responsibility for pipeline development, deal origination, due diligence and portfolio management typically sits with the intermediary, which may be a standalone entity or part of another organisation. Intermediaries may be impact investment firms, banks, charitable trusts and foundations, or entities set up for the specific purpose of deploying funds on behalf of investors. Funds may be held on the balance sheets of intermediaries or within fund structures managed by the intermediary. The details of how a fund may be structured are subject to a number of variables, including:

- The type of investment (i.e., debt or equity) that the fund intends to deploy to social impact enterprises.
- How investors intend to invest their capital into the fund (e.g., debt, equity or grant);
- Investor governance and regulatory requirements, for instance whether investors have a decision-making role in fund investments to be made or whether they have management responsibilities.

- Investor terms and requirements; for example, how long their capital is outstanding, return requirements and liquidity preferences.
- The costs associated with deploying the investments/management fee.

Blended capital structures, which combine concessionary capital (for example, from philanthropic sources) with non-concessionary capital can attract more conventional investors to impact funds and support the development of more flexible and risk-tolerant investment products (see page 23 for a discussion of how blended capital structures can leverage new capital for the CCS)<sup>45</sup>. In some cases, concessionary capital can be used to subsidise the operating costs of a fund, which can reduce the cost of capital to investees.

3

# The opportunity for impact investing in the cultural and creative sectors

## The need for transformative models

The CCS are at a critical juncture, in the UK and globally. Audience behaviours are being disrupted across the gamut of the industries, from the upending of entertainment consumption models by streaming services<sup>46</sup>, to shifts in attendance patterns after the pandemic<sup>47</sup>, to broader changes in preferences across demographics, at least in part driven by rising inequality/changes in wealth and income distribution<sup>48</sup>. Artists' rights are in the news at the point of publication, from the Hollywood strikes to the issues surrounding the ownership of Taylor Swift's masters<sup>49</sup>, and debate rages over the wider threats and opportunities posed by rapid evolution of artificial intelligence, while blockchain developments may hint at more equitable rights models for the future. Enabling artists to participate equitably in the success of their work is not only fair, but is vital to ensuring a healthy forward pipeline of talent and skills, work and content.

At the same time, public and philanthropic funding mechanisms for the cultural sector are undergoing a

comprehensive interrogation in terms of where the funding comes from, where/whom it goes to, and how it gets there; with a particular lens on whether these structures are upholding legacy inequities<sup>50, 51, 52, 53</sup>.

These uncertainties occurring in conjunction could conceivably engender a retreat of capital from risk, which carries the potential to stifle innovation, removing incentives to create, programme or produce groundbreaking work. At the creator/'content' level, worrying trends are emerging around the increasing challenge for new artists to 'break through', as streaming services dominate content consumption<sup>54</sup> and recommendation algorithms cement preferences, and the age and profile of festival headliners<sup>55</sup> make headlines<sup>56</sup>.

In this environment, new approaches to investment, and particularly those with the ability to unite funders around common social outcomes, could be transformative to the sector.

## Assets to invest in

CCS organisations have a diverse array of assets, both tangible and intangible. While there are obviously physical assets in many cases, such as buildings and collections, there is also a generally underexploited intangible asset base in the form of content, intellectual property and organisational networks. The value of these assets has arguably been underexploited, particularly in the context of strong international demand for cultural content, due to a lack of proprietary capital to invest.

Organisations with access to investment capital have incentives to explore how these assets could be developed to generate revenue. Funding these projects through grants can diminish the focus on return on capital calculations, as the budgets will normally be developed and assessed with more attention on immediate cashflows, and longer-term forecasts may be subject to less rigorous evaluation without the requirement of generating investment returns. The availability of capital to invest may thus

inspire a reimagining of the revenue-generating potential of assets, and allow organisations to participate in the future successes of their originated projects. This ability to generate cash, internal capital, can in turn support development of new ideas and initiatives.

### Example:

In 2016, with the help of a loan from Arts Impact Fund, Soho Theatre Company launched its own video-on-demand streaming service, Soho Theatre Player<sup>57</sup>, for which the initial content was a collection of ten self-produced episodes of stand-up comedy that leveraged its extensive network of acclaimed comedians. The content is available to stream directly from the service for a fee, while licensing arrangements were entered into with broadcasters and streaming services such as Amazon Prime to maximise value and drive new audiences.

## New venture models

While legal forms can be constraining, with non-profits usually unable to take equity investment, new models are also emerging that occupy the space between charity/subsidy and commercial/purely for profit, opening up the possibility of a greater diversity of investment models.

Legal forms able to take equity, such as community interest companies (CICs), or certifications such as B Corp that reassure investors that the social mission and integrity of an organisation is protected, are broadening the options for investors seeking impact. Hybrid models such as trading subsidiaries/joint ventures are also a possibility for cultural organisations with potential growth assets but without the immediate cashflows to service a debt investment.

### Example:

In The Room<sup>58</sup> is a conversational AI start-up founded as an R&D project within the National Holocaust Museum and Centre, which remains its majority stakeholder, part-funded by an impact loan into the museum. The project, initially a 3D holographic projection using natural language processing models, was developed as a technology-driven response to the challenge of preserving the experience of direct interaction with a Holocaust survivor, which was a fundamental element to the visitor experience offer.

In The Room's founder, Sarah Coward, has observed that having a cultural organisation as majority shareholder lends credibility and integrity to the organisation when dealing with partners and customers, while the museum's stake gives it access to the exciting growth potential of the venture. In The Room is part of Innovate UK's Global Incubator Programme, recently travelling to Toronto in partnership with MaRS, as one of 'the UK's most promising start-ups'<sup>59</sup>.



## The opportunity for system change

In countries such as the UK, Canada and Australia, where the existence of significant public funders has traditionally supported a dichotomy between 'subsidised' and 'commercial' activity, impact capital provides an opportunity to explore the space in between, expanding the options for equity investment.

Some activities, such as outreach programmes and work with disadvantaged communities, cannot attract revenues without undermining their impact; and some new work or artistic practice will not be predictable enough for investment and therefore requires grant funding, at least for proof-of-concept, so grant capital will always be vital for the sector. However, there are also opportunities to invest in assets or ideas that will not be suitable or eligible for grant funding. Impact investment can use a

'cross-subsidy' lens to look at the impact at the organisational level: the investment can develop an asset, and the associated revenue stream can be reinvested in the impact-delivering activities of the broader organisation. Public funders are also keen to expand the range of funding tools available to them.

Georgie McClean, Executive Director, Development and Partnerships at Creative Australia, tells us *"...we are now operating under new legislation that enables us to take an equity position, which under our previous legislation we couldn't. We have traditionally been a grant maker, but we now talk about ourselves as an investment and development agency. So newer approaches like impact investing are increasingly part of our narrative and are likely to feature in the way we think about our role."*<sup>60</sup>

## What does impact investment offer the cultural and creative sectors?

For CCS organisations, impact investment has the potential to bring in much needed new and affordable capital while also helping them develop their capabilities in monitoring, evaluating and communicating their impact.

The mindset generated by taking on impact investment can also be markedly different from a grant-funded mindset, with organisations being supported by the former to encourage both innovation and long-term thinking. Prevalent availability of grant subsidy over investment capital can incline organisations towards scoping activity in accordance with available grant revenues, rather than developing more sustainable, less grant-dependent

business models and investable business units. Predicating project development by default on grant funding might portend a version of the downward spiral illustrated by American cultural theorist Michael Kaiser, in *Curtains? The Future of the Arts in America*: less capital, less activity; less activity, less growth; less growth, less viability<sup>61</sup>.

Wakiuru Njuguna of Heva Fund agrees: *"...for these businesses, I believe sometimes grants can really make businesses restrict their own growth. And so I don't particularly believe in one way of investing or one way of working within the creative sector. I think a combined approach to investing... is what is needed to grow and sustain the creative economy."*<sup>62</sup>

## Extending the pool of available capital: Blended finance, leverage and recycling

The possibility of financial return suggests that impact investment has the potential to grow capital flows into the arts through the addition of capital holders for whom financial return/capital preservation is a priority and who would be unable to make purely philanthropic transfers of funds. Moreover, the focus on impact evidence implicit in this form of investing has the potential to draw in funders driven by evidence underpinning the credibility of an intervention, rather than by the cultural or creative practice inherent in it.

The power of leverage, achieved through the structuring of impact investment funds is also key to expanding investable capital. The participation of lower return- or higher risk-inclined capital within a fund – from a philanthropic or public sector funder, for example – can catalyse the participation of higher return- or lower risk-inclined capital, such as from banks or private capital. This is often done by providing a ‘first loss’ or credit protection layer within a fund structure, or by providing a guarantee. Funders primarily motivated by sector or impact objectives can play a unique, catalytic role in this respect because of their capacity to invert the

traditional risk-return dynamic, which expects higher returns for higher risk investments. This layer within a blended capital structure is often referred to as ‘catalytic’ or ‘concessionary’ capital.

Recent reports for the UK’s Department for Culture, Media and Sport by New Philanthropy Capital<sup>63</sup> and for Big Society Capital by Change Coefficient<sup>64</sup> discuss this in greater detail. Interest in these models is also evidenced by recent events at the European Bank for Reconstruction and Development and a series for the Global Impact Investing Network Investors Council focused on blended finance.

Finally, in terms of the capacity to expand capital available, the repayable aspect of investment can allow funds to be redeployed to the sector – often referred to as ‘recycling’. This is particularly true of debt, while equity investors may wait years for an exit. In practice, the same capital can be used multiple times over compared to non-repayable funding. In this way, for example, Arts & Culture Finance’s Arts Impact Fund was able to make loan commitments 1.3x the size of its original investable capital.

## Impact investing or just... investing?

It might be argued that investment without the impact lens could achieve many of the same outcomes for the CCS, and would have fewer constraints on its deployment, while requiring less of investees. However, the primary concern for many organisations looking for capital may be economic factors such as the affordability and flexibility of loan repayments, or the overall cost of capital<sup>65</sup>. Particularly for debt investments, investors seeking impact may be prepared to take a lower financial return when significant impact will be delivered, so this in practice is likely to have a positive effect on affordability. This impact may not need to be ‘social’ in the sense generally accepted within impact investment – an investor motivated purely by the intrinsic benefits of the arts may well forgo reporting

around instrumental social outcomes. In addition, for organisations looking in any case to understand better or to boost their social impact, working with an impact investor can be beneficial.

In terms of growth or higher-return investment opportunities which may be suitable for equity capital now or in the future, there are also instances of financial innovation in the CCS<sup>66</sup>. There are, for example, initiatives in the creative industries specifically aiming to use investment capital to support economic growth and local development, such as Creative UK’s Creative Growth Finance<sup>67,68</sup> in the UK which recently launched a £35 million fund in partnership with Triodos Bank, which is forging the way for creative industries-focused investment strategies.

## The investment relationship

The value of impact investment in arts and culture goes beyond the purely monetary considerations of leverage, new capital and recycling. There is something to be said about the investor-investee relationship relative to the relationship between grantmaker and grantee.

Firstly, the former is typically a longer-term relationship: while it's uncommon to see a grant award being made over a period greater than three years, investment realisation timeframes frequently exceed even five years. Secondly, the investor aims, by definition, to get their money back, which means that they are incentivised to closely monitor, understand and support the investee to affect this outcome. Finally, and depending on the investment mechanism, the possibility of legal recourse for investors can sometimes create stronger incentives

for investees' engagement; while there may be the possibility of grant claw-back in some grant agreements, a grantmaker is rarely a creditor and therefore lacks the protections offered to creditors by law in most jurisdictions, such as the ability to petition for the wind up of a business should repeated demands for payment in the event of default be unforthcoming.

For an existing CCS funder aiming to bring about some kind of behaviour change in funded organisations, which is generally accepted to be a challenging and long-term process, there are advantages to embracing an investment relationship. Behaviour change can be incentivised by building relevant indicators and milestones into the terms of the investment, for example, as ongoing reporting conditions.

## Impact leverage

The Cultural Impact Development Fund (CIDF), another fund within the Arts & Culture Finance initiative (see p.24), used the investment relationship to drive improvements in cultural organisations' capabilities for delivering, monitoring and articulating greater impact. Each underlying loan agreement included:

- A covenant requiring compliance with an impact development plan, which set targets related to outcomes, outputs and monitoring and evaluation.
- Information covenants requiring social impact reporting on a quarterly basis, as well as a more in-depth annual report.
- Provisions for annual reductions to the underlying interest rate of the loan, should certain impact targets be achieved; effectively this was an experiment in providing a financial incentive for the achievement of social impact.

While it remains too early to say definitively whether these features brought about positive changes to the impact capabilities of CIDF's borrowers – the fund allocated its investment funds over the period 2018-2021 – there are encouraging early signs, including a high level of engagement with the process as well as the achievement of impact targets qualifying for reductions in the interest rate.

Through the use of similar covenants and incentives as part of the investment agreement, the investment relationship could complement efforts to bring about changes in other spheres, for example to encourage more environmentally sustainable behaviours and outcomes or greater compliance with equality, diversity and inclusion-related goals.

# 4

## How impact investment can work in the cultural and creative sectors

### International examples

Our research has surfaced some interesting examples of impact investing in the cultural and creative sectors from around the world. Before diving into an in-depth case study of the Arts & Culture Finance initiative, we highlight the key projects working at this intersection at both the cross-border and in-country level.

The Creativity, Culture & Capital (CCC)<sup>69</sup> initiative, a partnership between Arts & Culture Finance, US-based Upstart Co-Lab and Argentina's Fundacion Compromiso, with support from the British Council's Developing Inclusive Creative Economies programme, SOCAP Global, United Nations Conference on Trade And Development and the Global

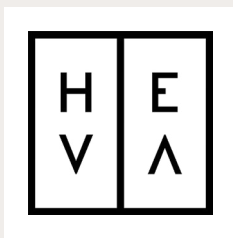
Steering Group for Impact Investment, launched in 2021 to coincide with the UN's International Year of the Creative Economy for Sustainable Development. This project highlights one hundred impact initiatives in the global creative economy and innovative funding models used to support them. A European Community of Practice is emerging in impact investment for the cultural and creative sectors, loosely managed by MitOst in Berlin adjacent to its Tandem for Culture<sup>70</sup> network, and impact investment bodies and gatherings (such as European Venture Philanthropy Association<sup>71</sup>, Asia Venture Philanthropy Network<sup>72</sup> and Global Steering Group for Impact Investment<sup>73</sup>) are increasingly featuring culture and creativity in their event programming, which is also helping to highlight new developments and emergent practice.

Some illustrative global initiatives in this space are highlighted on the following page.



### Upstart Co-Lab

Upstart Co-Lab<sup>74</sup>, a US not for profit organisation founded in 2016 in New York, connects impact investment to fashion, food, film and TV, video games and other creative industries to drive deep social impact. Since inception, Upstart has mobilized \$45 million towards its mission and is currently raising the first impact investment vehicle for the US creative economy<sup>75</sup>.



### HEVA

HEVA<sup>76</sup>, launched in Nairobi in 2013, has generated insights, rolled out more than 100 investments in creative businesses and projects, and innovated financial models specifically for the growth of the creative economy in East Africa.



### DOEN Participaties

The main objective of DOEN Participaties<sup>77</sup> is to achieve a positive impact on society by supporting new sustainable or socially inclusive entrepreneurs. Impact is central to all the organisation's investments. Over the past 25 years, DOEN Participaties has become the biggest impact investor for sustainable and socially inclusive start-ups in the Netherlands. Currently, the portfolio consists of 50 equity investments and convertible loans, and 18 fund investments.

## UK: Arts & Culture Finance

Given the authors' greater access to the workings of Arts & Culture Finance (ACF) in the UK, we present a fuller case study of this initiative below. This section is not intended to serve as a formal evaluation of the funds or the ACF project as a whole since repayments to all funds are ongoing.

ACF, which was incubated by the innovation agency Nesta between 2015 and 2023, has been the most active impact investment intermediary in the cultural sector in the UK during this period – and, most probably, in the world. ACF started as a single project, the Arts Impact Fund, which was designed to explore arts organisations' willingness to take on loans, and their ability to repay and persuasively account for their impact. The portfolio of investees grew over time and, after the launch of the CIDF in 2018, the funds were collectively positioned to the CCS as ACF in 2018.

The purpose of ACF as the intermediary is to:

- Raise awareness and understanding of impact investment as a source of capital in the CCS;
- Develop a pipeline of investment enquiries to its funds;
- Carry out due diligence and develop investment applications to the relevant funds;
- Administer and manage the portfolio, ensuring that investee reporting is carried out and deal and fund-level performance is communicated to investors.

With the launch of each successive fund under the ACF banner, there was an opportunity to expand the market testing hypothesis, iterate and expand the product, and, ultimately, build the sector's capacity to deliver more work through affordable risk capital.

All funds managed by ACF are examples of structured blended finance, where grant funding leverages in significant quantities of tiered repayable capital, all of which is united around a set of core outcomes for the ACF initiative:

- Increasing access to affordable sources of repayable finance for CCS organisations;
- Increasing awareness of impact investment as well as repayable finance more broadly in CCS;
- Improving the financial resilience of organisations taking on finance;
- Leveraging additional funding for CCS organisations, both at the individual deal level and at the portfolio level;
- Building capacity to better monitor, evaluate and articulate social impact in the sector;
- Growing the social impact of investees.

A cautionary note is that the focus on ACF necessarily limits this section's scope to debt investments. ACF's impact investment practice represents what some impact investment taxonomies call 'social investment' or 'concessionary capital', where the impact and financial risk are not offset by unlimited upside as in an equity or venture investment. The broader universe of impact investment opportunities in the CCS encompasses a wider range, including equity investment into creative enterprises delivering positive social outcomes. ACF's investment universe is predominantly, though not exclusively, asset-locked not-for-profit organisations unable to take equity investment.

## Fund structuring

Across the three funds, the grant capital has come from both public and philanthropic sources (Arts Council England, National Lottery Heritage Fund and The National Lottery Community Fund), while the repayable capital, made by way of loans into the funds, has come from philanthropic and private sources (Esmee Fairbairn Foundation, Freelands Foundation, Nesta, Big Society Capital and Bank of America). With each new fund, there has been an increase in the grant to loan leverage (from 1.33 in the Arts Impact Fund to 3.00 in the Arts & Culture Impact Fund), demonstrating the potential of the model to crowd in new money.

Each fund model was built by solving for a manageable cost of capital for the end investees; projected investor returns were ultimately determined by this, operating costs, projected credit costs and their relative impact and return prerogatives. The building of a functional piece of market infrastructure was an explicit aim, and duly prioritised by the investor group. As Karim Harji observes, if "...there is disproportionate focus on the supply side of capital... having the tool lead the conversation can get you into a kind of trouble." Harji recommends the opposite, asking what tools *"are most valued in helping organisations navigate some of the complexity or variability around income streams"*<sup>78</sup>.

The following table provides an overview of the funds and their performance.

Fund	Investment period	Size	Investors	Grant to loan leverage*	Investor returns**	Product offer	No. deals made and forecast capital losses***
Arts Impact Fund	2015 – 2019	£7m initially	Arts Council England, Esmee Fairbairn Foundation, Nesta, Bank of America	1.33	Investor loan capital – 1%-3%	Unsecured loans, £150k-£600k 3%-8.5% interest Repayments over 3-5 years	27 deals; live portfolio of 11 Forecast losses: 13%
Cultural Impact Development Fund	2018 – 2021	£8.6m loans made due to recycling	National Lottery Community Fund, Big Society Capital	1.93	Initially 5%, revised to 2% following the pandemic	Unsecured loans initially, £25k-£150k coupled with grants following the Covid-19 pandemic 5.5%-8.5% interest; interest discount possible on achievement of impact targets Repayments over 3-5 years	10 deals; live portfolio of 7 Forecast losses: 20%
Arts & Culture Impact Fund	2020 – 2023/4	£840k	Arts Council England, Esmee Fairbairn Foundation, Nesta, Bank of America, Heritage Fund, Big Society Capital, Freelands Foundation	3.00	Investor loan capital – 1%-3%	Secured and unsecured loans, £150k-£1m 3%-8.5% interest Repayments over up to 10 years	14; live portfolio of 10 Forecast losses: 7%

\* Grant to loan leverage shows how much £ of private or philanthropic loan capital was leveraged for every £1 of public grant funding.

\*\* Funds were launched in ultra-low interest rate environments.

\*\*\* Information correct at the time of publication, November 2023.

## ACF approach to impact

ACF has developed its own framework for assessing social impact in the course of developing its investment applications. This has been an iterative process, balancing investor requirements, sector capabilities and the team's own internal capacities. It also took as a starting point the work of Nesta Impact Investments in its 2017 impact strategy<sup>79</sup>. It is worth noting that impact measurement across investors varies widely and the ACF framework may not be representative across the industry.

ACF's investors have, to date, not been prescriptive as to the positive outcomes they seek; instead, this is left for applicant organisations to define and articulate. Applicants are required to provide an overview of their work, after which the investment team identifies a core programme for deeper analysis as part of the due diligence process. The impact assessment aims to develop an understanding of the projected impact over the lifetime of the proposed investment by looking at both impact returns and risks of the core programme.

Impact returns are defined as the difference that the applicant aims to help bring about in individuals, groups, communities, organisations, or systems. The team is specifically interested in the outcomes that are within the organisation's accountability line – that is, the outcomes that the organisation aims to influence directly and holds itself accountable for – as opposed to the longer-term outcomes and impact that depend on a wide variety of conditions and factors that are beyond its accountability or control.

Impact returns are assessed through a review of the documents and evidence relating to the applicant's impact aims, such as its theory of change, programming plans, and internal and external evidence of need among service users. This assessment has three dimensions:

- **Need:** the measure of the gap between the current conditions of the intervention's target group and the desired outcomes.
- **Depth:** the level of outcomes experienced by the target group, or the measurable or observable changes in attitudes, behaviours, knowledge, skills, or circumstances that the organisation aims to help bring about in individuals, families, communities, organisations, or systems.
- **Scale:** the number of users reached in each year of the investment period who meet both the organisation's and the fund's target group criteria.

Impact risks are defined as the factors, both internal and external to the organisation, that affect ACF's confidence that the organisation will be able to achieve its projected impact returns. The risks are assessed against three areas:

- The appropriateness of the impact model to the needs of the target group, the extent to which it is evidence based and credible in relation to the desired outcomes.
- The extent to which the organisation is able to deliver the impact model to a high standard; whether it has the appropriate resources, frameworks, and experience across its personnel.
- The extent to which the organisation has the appropriate frameworks, processes, and capacity to measure and manage the outcomes within its accountability line. If the above two impact risks relate to capability to affect positive outcomes, this risk concerns the capability to provide evidence for these outcomes having taken place.

The impact assessment forms a core part of the investment application that is submitted to the relevant fund's decision-making committee. On entry to the portfolio, an impact development plan and evaluation framework is developed collaboratively with the investee, centred on the core programme, which is the basis for establishing potential impact returns. The development plan and framework identifies key outcomes targets and corresponding indicators for the programme and is used as the basis for impact reporting for the duration of the investment.



While all ACF investment officers contribute to the impact assessment, the work is largely led by the team's impact manager, a role that was introduced to ACF with the launch of its CIDF. This role has been crucial to developing ACF's impact framework and to supporting applicants and portfolio organisations to develop their impact management capabilities. A key part of the role is to bridge the divide between the sometimes esoteric, technical language common to the field of impact management and the day-to-day work of the organisation.

## Understanding the portfolio

Between 2015 and 2023, ACF was able to make 51 loans across its three funds, representing investment commitments of £14.6 million<sup>90</sup>. At the time of writing, nearly half of all capital deployed to cultural organisations has been repaid, with the outstanding balances distributed across 28 organisations. Of all the loans made across all funds, four have been terminated due to borrower insolvency; across these four cases, £383,000 has been written off to date, representing a current write-off rate of 3.4% on deployed capital.

The 51 investments made by ACF span most major art forms – music, literature, theatre, dance, painting – as well as museums, creative education institutes, heritage organisations and workspace providers. On average, organisations in the portfolio work with at least three different beneficiary groups; just under three-quarters of organisations have activities aimed at reaching children and young people, and 31% of organisations have provisions reaching or targeting those from the global majority.

In terms of the impact, as well as contributing to a wide range of outcomes specific to the CCS, it is estimated that the work of each investee contributes to 2.7 UN-SDG outcome areas, on average. Nearly three-quarters of investees are delivering work that is aimed at reducing inequalities. 66% are working towards quality education and 59% in providing opportunities for decent work and economic growth. To give specific examples of what social impact delivery may look like in practice:

- **Royal Shakespeare Company:** a renowned theatre company that also delivers an education programme in schools based in areas of structural disadvantage to improve young people's literacy as well as their self-belief in their capacity to learn.
- **Future Yard:** a music venue that runs a programme for young people aged 14-24 to develop the skills, understanding and confidence required to pursue careers in the live music industry.
- **InHouse Records:** a record label that uses music production activities to effect positive behaviour change in the prison population, including reducing the rate of re-offending and creating pathways to further education and training.

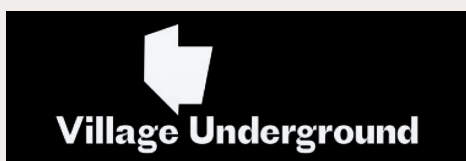
While a fuller discussion of income models in the portfolios is outside the scope of this report, fundraised income (either through public funders such as Arts Council England, trusts and foundations or individual giving) is a key part of the income mix for most portfolio organisations. The level of so-called 'unearned' income varies from 0 to around 80% in some cases, but aspirations to greater self-reliance and increased diversification of income sources have underpinned the majority of investment cases in ACF's funds.

The specific uses of borrowed funds vary widely e.g., buying property, paying for staff, paying for services, upgrading fixed assets. Spending on buildings and premises – either to acquire or refurbish – was a core component of 58% of deals. In terms of a more meaningful taxonomy of 'end' use cases, the following table shows three broad categorisations and the proportion of cases across the portfolios in which they appear. For this analysis, we have

relied on the judgement of ACF investment officers closest to each investment. We should also note that for many deals, there is more than one use case – for example, a loan might ultimately be used to grow existing activities and try out some new ones.

The appetite for developing new income-generating activities (essentially a form of corporate venturing) is both striking and encouraging.

	Proportion of deals
Sustaining existing activities (e.g., loans to manage cashflows from existing activities)	25%
Growing existing activities	63%
Developing new activities	54%



### Case Study: Village Underground

A live music venue in the London borough of Hackney, took on a £600,000 loan from AIF that, alongside funding from other investors, allowed it to take on multiple leases representing different venues in one large building, a former art-deco cinema, also in the borough<sup>81</sup>. After extensive refurbishment works at the property, the site was reopened as the EarthH arts centre, which included a new hospitality and catering offer, a new venture for the company. A new music education and production suite has also been built into the site where, in partnership with local arts charities, young people from the borough have the opportunity to gain key workplace skills.

In just over half (54%) of all cases, ACF's investment sits alongside other money, either grant or other investment. This funding might come from local government, trusts and foundations, individuals, and other investment intermediaries. In these co-funded cases, ACF's funds contribute to 38% of the project cost

on average. How essential is ACF's funding to a particular project going ahead? ACF's investment officers estimate that in 21 of the 51 deals (40%), its funding was essential. Of these, nine were co-funding/investment structures where ACF's investors effectively unlocked £1.80 with every £1 of their own capital.

Beyond this, some borrowers have commented that going through the due diligence process with an investor is an endorsement in itself, which has positively impacted their ability to raise further funding:

**“If Arts & Culture Finance has lent you money, then other financial organisations know you have gone through strong due diligence and that gives them more comfort.”<sup>82</sup>**

Nichole Herbert Wood, CEO, Second Floor Studios & Arts

Impact investment in the cultural sector is typically collaborative and, if deployed appropriately, can be catalytic to organisations and their projects, with significant leverage potential.

### Fund performance

The current average write-off rate<sup>83</sup> across all funds of 3.4% is considerably lower than the equivalent figure estimated at the fund design stage. However, given that each fund is at a different stage in its lifecycle and there is a tendency for losses to be 'back-loaded' (i.e., companies are less likely to run into difficulties at the outset of an investment), it is likely that the final level of write-offs across all funds will be much higher – although still lower than what was modelled at the outset, as the following table indicates.

	Modelled		To date		To date and current provisions		Team's current estimate		Projected fund life
	%	£'000	%	£'000	%	£'000	%	£'000	
AIF	15.4	1,032	4.6	335	17.1	1,238	13.0	943	2015-2025
ACIF	7.7	1,386	0.0	-	0.0	-	7.0	1,260	2020-2032
CIDF	25.0	210	5.6	47	17.1	143	20.0	168	2018-2026
Average	16		3.4		11.4		13.33		
Total		2,682		383		1,381		2,371	

### Explanation of table column headings

**Modelled:** The write-off rate estimated at the fund design stage. Variance across funds reflects the expected risk profile of each fund, which is a factor of the expected resilience of the typical borrower in the fund and whether the fund will undertake collateral-backed lending.

**To date:** Actual write-offs of deployed capital at the time of writing.

**To date and current provisions:** In addition to actual write-offs, ACF makes a provision for

capital that is at risk of being written-off within the year. The percentage of capital provided for may go up or down depending on borrower circumstances, with risks regularly reviewed; as such, this metric should be seen as a prudent current snapshot of possible total losses.

**Team's current estimate:** Given that there remains a significant period of time before all deployed funds are due to be repaid (2025 for AIF, 2026 for CIDF, 2032 for ACIF), this metric gives the team's current best guess of the total write-off rate for each fund, taking into account their understanding of all current borrowers.

After taking into account these loss rate estimates, it is expected that all capital and interest payments will be realised within the agreed timeframes, something that is made possible by the grant layer in these funds, which is designed to absorb loan write-offs across the portfolios. A further indicator of positive performance is that Bank of America's senior facility in the Arts Impact Fund was repaid in 2021, one year ahead of schedule.

Keeping loss rates low has been possible only through the flexibility that ACF and its investors are prepared to exercise towards borrowers, where it is clear that borrowers are a viable going concern<sup>84</sup>. In addition to the blanket forbearance on capital and interest payment offered to portfolio companies in 2020 as a result of the Covid-19 pandemic, loan repayment profiles have had to be restructured at some point in nearly all cases, sometimes multiple times. Restructurings may typically involve capital repayment holidays and extensions of the loan term and are often instrumental in supporting the borrower through challenging trading conditions. Loan variation proposals are developed following reviews of borrowers' financial performance and operating conditions and submitted to the relevant fund investment committee for approval.

The ACF data leads us to a preliminary conclusion that a blended model of debt-based impact investment in the CCS can succeed in delivering expected returns to investors,

provided that funders and intermediaries are able to commit to the project over a time horizon<sup>85</sup> that allows for the overcoming of challenges in the operating environments of the underlying borrowers. A significant caveat is the fact that all of these funds were structured in a low interest rate environment and, even then, lenders into the funds were committing to discounted sub-market returns in exchange for a mission-related investment.

This is a modest but encouraging conclusion. Modesty pertains to the fact that no claims are being made around the economic potential of the CCS as a whole; ACF uses debt-based investments that were designed to be affordable to the sector. A separate discussion would be required to assess the viability of the sector to achieve the higher financial returns in a higher interest rate environment or a returns profile more usually associated with equity investment. Also, while it is ACF's aspiration to have portfolios representative of the sector as a whole, applicants are ultimately self-selecting. We cannot infer from these organisations general conclusions about the universe of opportunities that could benefit the most from impact investment. There may, for example, be organisations who could benefit tremendously but do not have the awareness or capacity to apply successfully for it<sup>86</sup>. Nonetheless, the encouragement lies in the fact that the leverage-based impact investment model can work for many organisations in the CCS.

## Impact on investees

In order to monitor and evaluate the impact of ACF's lending on its borrowers, the team undertakes annual portfolio surveys and encourages recently repaid borrowers to complete an exit survey. Annual surveys indicate that the majority of investees believe taking on investment has helped their organisation to achieve its business, financial and impact-related objectives: 81% of investees think guidance from the team improved their approach to measuring and evaluating their impact at least moderately, with 38% stating they had improved a great deal. These findings are also replicated in exit surveys (albeit with a smaller sample size).

Three out of every four respondents agree that they have been supported to both use their impact findings to improve the way their organisation works and improve the way they communicate their impact to stakeholders. There is also some evidence to suggest that taking on investment has led to improved financial resilience in the Arts Impact Fund portfolio<sup>88</sup>. Over 50% of borrowers experienced increases in eight out of nine resilience metrics<sup>89</sup> in the period after taking on their loan, compared with the period before. In follow-up interviews only 13% responded by saying that the loan had not improved financial resilience<sup>90</sup>.

**“Working with Arts & Culture Finance not only helps us to understand our social impact with greater depth but also how we can develop it. Social impact has become integral to our business model and our future aspirations for our work.”<sup>87</sup>**

Tara Cranswick, Director, V22

# 5

## Creating the conditions

### International

Whilst ACF has invested exclusively in UK CCS organisations during its incubation period, it has also been active in 'field-building' for impact investment in the CCS at a global level, through the Creativity, Culture & Capital initiative and through active dialogue with interested parties internationally. The Creative Industries Policy and Evidence Centre highlighted the need for a

coordinated approach for the development of alternative finance models, and impact investing in particular, in its Global Agenda.

Part of the rationale for creating an international coalition is to make the case for and work towards the establishment of a global fund, or pooled capital vehicle, focused exclusively on the CCS, or the broader creative economy.

#### **The hypothesis is that a dedicated and intentional international pool of capital/wholesaler could:**

1. Catalyse the development of local intermediaries by making available seed capital to cornerstone local funds.
2. Build a powerful, extensive and diverse evidence base and illustration compendium for the financial and social returns generated by the cultural and creative sector.
3. Advocate in the broader impact investment community for the positive impact generated by the creative and cultural sectors, growing both the pool of impact capital and the access of the sector to that pool.
4. Share learning across geographies and develop models of best practice for intermediaries, including stakeholder management, operating systems and processes, impact evaluation, management, measurement and evaluation.
5. Share skills and experience to expedite the development of functional local and international CCS funding infrastructures, including skills development, training and qualifications, with a focus on inclusive talent pipeline development.
6. Drive understanding of the potential of impact investment for the CCS by making capital available at scale.
7. Facilitate international collaboration on the development of a shared impact language for the CCS.
8. Support and enable international scaling and cross-border partnerships and collaborations between CCS/creative economy organisations.
9. Facilitate international trade of cultural and creative products and services.

## Local/national

Over and above the creation of a global CCS impact investment fund/wholesaler, policymakers or other national stakeholders can investigate the following questions and take steps to create the conditions for a flourishing impact investment infrastructure for the CCS:

### Education

- Raising awareness in the CCS of impact investment and the possibilities it can present to invest in and develop their assets.
- Outlining the process of taking on impact investment and managing an impact investor, including but not limited to business planning, impact planning and management (including developing a theory of change/outcome metrics), modelling and managing cashflow projections, expectations of the due diligence process, governance and management expectations.

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### Stakeholder mapping and convening

- Investigate to what extent there is an obvious provider of catalytic capital (such as a public or philanthropic arts/impact investment/creative industries/research funder; high net worth individual or trust/foundation motivated by the sector and by innovation in funding models).
- Explore the range of stakeholders involved in a strong cultural and creative sector and their appetite for participation in impact investment.
- Determine the appetite of policymakers for involvement to ensure a supportive policy environment.

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### Fund structuring

- Mapping investors' motivations, constraints, tolerances and target outcomes (e.g., a public arts funder may be accustomed to forfeiting all or most of their investment,

and interested primarily in leveraging new money/engaging new participants or new mechanisms of participation in the funding paradigm; a new entrant may be focused on capital preservation).

- Costing the provision of the investment/intermediary function, taking care to ensure an ethical supply chain, and ensuring adequate provision for marketing of the opportunity to pipeline organisations/deal origination.
- Developing blended finance models that represent and optimise different financial and impact goals and constraints.
- Understanding the minimum level of subsidy required to run a successful pilot that can scale economically, ensuring e.g. standards expected of organisations such as environmental sustainability and living wages are considered.

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### Intermediary mapping

- Explore existing intermediaries operating in this space.
- Examine what support these intermediaries might need to scale; identify mechanisms for providing this support.
- Investigate the need for/advantage to developing a bespoke new intermediary focusing primarily on the sector; determine whether appropriate market experiments could instead be run through existing generalist impact investors.
- Map out the important stakeholders and critical pathways towards the creation of any new intermediary, taking into account existing and potential power imbalances, equity, diversity and inclusion.

## Pipeline/investment universe mapping

- Investigate how many and what types of organisations could/would/can take on an impact investment, and how this might evolve over time.
- Establish a sense of the overall market size; commission a primary research tool intended to support the data above (and, as a second order effect, generate interest).
- Collect examples of what types of projects would be funded, what cashflows they might generate over what time period, what other exit/payback models (e.g., refinancing/sale) might look like; where possible investigate the prevalence and distribution of these examples to inform a sense of the overall market.
- Collect further information about the likely investable universe e.g. size (employees, revenue), geography, asset base?
- Explore what quantum of investment might be required and how this is distributed
- Establish what kind of return expectations/cost of capital the investment universe can support/tolerate? This is critical to building a feasible model and ensuring the developing market isn't stifled by an excessive cost of capital.
- Map out the dominant legal forms of sector organisations and what kind of capital they can take.
- Are there any implicit biases in the proposed investment offer (e.g., some types of organisations may be culturally debt-averse)?

## Support requirements

- How much support and technical assistance is required to get organisations to comply with eligibility and investability requirements, considering both impact and financial standards?
- Is there additional support required for organisations to meet standards around e.g., ethical employment, environmental compliance, supply chain compliance, EDI targets?
- Are there sufficient de-risking initiatives such as grant funds, structured R&D support and incubators/accelerators to ensure that portfolios fully represent the potential of the sector? A diverse and exciting pilot portfolio will be critical to raising additional funds at scale.

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## Impact/outcomes

- How developed is impact practice within the investable universe?
- How compatible are the impact requirements of investors with this e.g., could an initial prototype fund introduce the sector to investment ahead of bringing in an impact hurdle?
- What is needed to support impact measurement and evaluation capacity within the investable universe?



## Case Study: Canada

The authors of the report collaborated with Canada Council for the Arts, Camber Arts, and the Metcalf Foundation on an exploratory summit, held in person in Toronto in July 2023, aimed at examining the feasibility of impact investing in the cultural and creative sectors in Canada.

The summit assembled public funders (both national and international), impact investors, philanthropic grant funders, academics and cultural and creative practitioners to establish

1. whether the environment in Canada was conducive to such an initiative; and
2. if so, what it would take to build a constructive pilot.

As a result of this, further exploratory design work is in the process of being commissioned.

All attendees noted the vital importance of having the full range of stakeholders in the room from the outset, in line with our earlier points about market testing and product design being key to establishing a functional and long-lasting piece of funding infrastructure, as this quote from Karim Harji reflects:

**“[There are] important implications for those in the nonprofit sector seeking to engage in impact investing. The first consideration is the importance of having sector voices heard within industry-building efforts in order to credibly situate the role of nonprofits beyond simply the recipients of impact investments. The second is to develop the capacity and skills within the sector to comfortably engage with the private sector and government in negotiating new structures, policies, and terms for impact investment. The third is to organise collectively – through existing industry associations or new sectoral or regional collectives – and engage proactively with investors to build shared agendas and common principles around how to use impact investing more effectively.”<sup>91</sup>**

# Conclusion

Investors are increasingly keen to use their capital in ways that do not just avoid harm, and benefit stakeholders, but also contribute to solutions. Holders of a significant and growing proportion of global investment capital want to use it to deliver positive outcomes, and are becoming more inventive about exploring different tools, strategies, and means to effect this.

CCS worldwide are effective at delivering positive social outcomes – for individuals, communities and society. The competencies central to cultural and creative activity – experimenting, embracing complexity, collaborating across disciplines, applying imagination and ingenuity, venturing into the unknown – are key to addressing many of the challenges faced by communities the world over. While essential, these factors can, as a corollary, mean that the impact delivered by CCS is more diffuse, presenting a challenge of measurement, representation and aggregation.

At the same time, CCS offer exciting investment opportunities, with digital technology in particular bringing potential to:

- Scale audiences dramatically, such as through performances in games<sup>92</sup>.
- Reach and engage new and underserved members of society, such as through VR experiences<sup>93</sup>.
- Develop new artforms and skills.

However, CCS have traditionally been understood and embraced only selectively by private investors, and therefore had limited access to development capital and support. A

new source of patient capital could enable a step change in productive development of the sectors' broad and compelling range of assets.

More traditional funders, such as public and philanthropic bodies, can play a critical role in developing new funding models which bring private capital to CCS in appropriate and constructive forms. An emerging network of impact investment practitioners are demonstrating models for understanding CCS and investing successfully, and these can be scaled and replicated. New endeavours are best designed as experimental discovery exercises rather than attempts to arrive at perfect interventions.

The key to successful impact investing and blended finance initiatives is collaboration. The priority is to build a coalition of motivated parties around the opportunity to develop a transformative tool for investing in initiatives delivering impact via the cultural and creative sectors. This shared goal is crucial – it enables the different parties to benefit from each others' skills, experience and perspectives; helps to overcome challenges an investor working alone may find prohibitive; and creates scale, critical mass and momentum.

We hope this report will help to inspire more experiments in this exciting area, and to assemble an international community of practice, so local and national efforts can learn from each other's experimentation. This will build impact investing in cultural and creative sectors into a powerful force for optimism and lasting change.

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88. Rachel Green. "To what extent does the experience of the Arts Impact Fund support its objective of improving the financial resilience of arts & culture organisations?". Thesis, Executive Masters in Cultural Leadership. University of Maastricht.
89. Resilience metrics are: gross income, earned income, share of earned income, no. of income sources, surplus/deficit, fixed assets, net current assets, net assets and cash reserves.
90. 'Did organisations think that the loan had improved their financial resilience?' Responses: Unqualified 'Yes': 47%; Qualified 'Yes': 40%; 'No': 13%.
91. Karim Harji and Tessa Hebb, "Impact Investing in Canada: Notes from the Field." In Susan D. Phillips and Bob Wyatt (Eds.), *Intersections and Innovations: Change for Canada's Voluntary and Nonprofit Sector*. Edmonton, AB, Canada: Muttart Foundation. 15.
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