

27 February 2017

Housing Unit Manager
Social Policy Division
The Treasury
Langton Crescent
Parkes ACT 2600

via email to socialimpactinvesting@treasury.gov.au

Dear sir/madam

Social impact investing discussion paper

The Australian Institute of Company Directors (**AICD**) welcomes the opportunity to provide a submission in response to the Australian Government's discussion paper on Social Impact Investing.

The AICD is committed to excellence in governance. We make a positive impact on society and the economy through governance education, director education, director development and advocacy. Our membership of more than 39,000 includes directors and senior leaders from business, government and the not-for-profit (**NFP**) sectors.

We commend the Australian Government's support for social impact investing. Governments play a critical role in the development of social impact investing markets, both through direct engagement as a participant and through providing the regulatory architecture that enables investment. The AICD believes social impact investment represents an exciting channel through which to address Australia's social and environmental challenges.

Summary

Our submission addresses the regulatory and governance environment in which NFPs operate as it relates to social impact investing and how the Australian Government could facilitate such investment through:

- Reducing the regulatory burden on NFPs (which is costly and, as a result, reduces the potential of social impact investments to achieve market returns);
- Providing guidance on the operation of an Australian social impact investing market, including on how such investments relate to NFP status and tax; and
- Supporting the development of social impact measurement.

Of critical importance to our submission is our view on whether a legal impediment exists that prevents directors of social enterprises from making decisions in accordance with the constitutional mission of the enterprise, rather than maximising financial returns.

The AICD considers that there is no such legal impediment, and that the law already provides flexibility for directors to consider and balance the interests of a range of factors in their decision-making, in furtherance of an enterprise's mission.

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

There are a number of barriers to the growth of social impact investing.

Regulatory burden

NFPs are subject to excessive, out-of-date regulation in a number of areas. Duplicated and unnecessary reporting, fragmented regulatory systems (such as those that govern fundraising) and a lack of consistency (such as in the collection of state taxes and the definition of charity) all contribute to a burdensome regulatory regime.

A report prepared for the Australian Charities and Not-for-profits Commission (**ACNC**) by Deloitte Access Economics has estimated that the cost of regulatory burden on charities alone (which represent only 10 per cent of the broader NFP sector) is \$34.85 million.¹ Streamlining, simplification and red tape reduction could reduce this burden by as much as \$29.38 million,² a model for which is set out in this report.

The effect of this cumbersome regulatory framework is that millions of dollars are diverted to compliance activities, which reduces the potential of social impact investments to achieve market returns. NFPs that engage in social impact investing activities are operating in commercial environments and must have an appropriate, fit-for-purpose regulatory regime to support this if they are to succeed.

The AICD notes that the Australian Government has already made substantial progress towards reducing the red tape burden for charities and that much of the remaining work to achieving a modern and fit-for-purpose regulatory regime lies with state and territory governments.

Understanding about governance, risk and financial strength

The AICD has conducted research into the NFP sector over a number of years. Our *2016 NFP Governance and Performance Study (the Governance Study)* highlighted that many NFPs are conservative in their approach to risk, appetite to investment and in their understanding of the importance of profit to long-term financial sustainability and strength.³

The Governance Study, which is the largest of its kind in Australia, found that some NFP directors felt that it was not appropriate (or, in some cases, even lawful) to make a profit. While this was not a view held by a majority of participants, it indicates a broader perception within the sector of a conservative approach to financial management. This would seem to indicate that some NFPs do not have the necessary skills and experience to participate effectively in the social impact investing market.

The AICD recommends that the Australian Government provide guidance to assist NFPs to understand:

- How the social impact investing market operates;
- The respective roles of NFPs, government agencies, investors and evaluators within social impact investing; and
- How social impact investing interacts with NFP status and taxation.

¹ Australian Charities and Not-for-profits Commission, 2016, *Cutting Red Tape: Options to align state, territory and Commonwealth Charity regulation*, <<http://acnc.gov.au/ACNC/Publications/Reports/CuttingRedTape.aspx>> (accessed 20 February 2017)

² *Ibid.*

³ Australian Institute of Company Directors, 2016, *2016 NFP Governance and Performance Study*, <<http://aicd.companydirectors.com.au/advocacy/research/2016-nfp-governance-and-performance-study-raising-the-bar>> (accessed 20 February 2017)

Supporting the development of independent evaluation

Central to the development of the social impact investing market is the capacity of independent evaluators to measure resulting social impact. However, social impact measurement and evaluation is relatively immature as a discipline and often prohibitively expensive, especially for smaller NFPs.

The AICD recommends that the Australian Government give consideration to supporting the development of this practice, which it could do through a number of ways, such as:

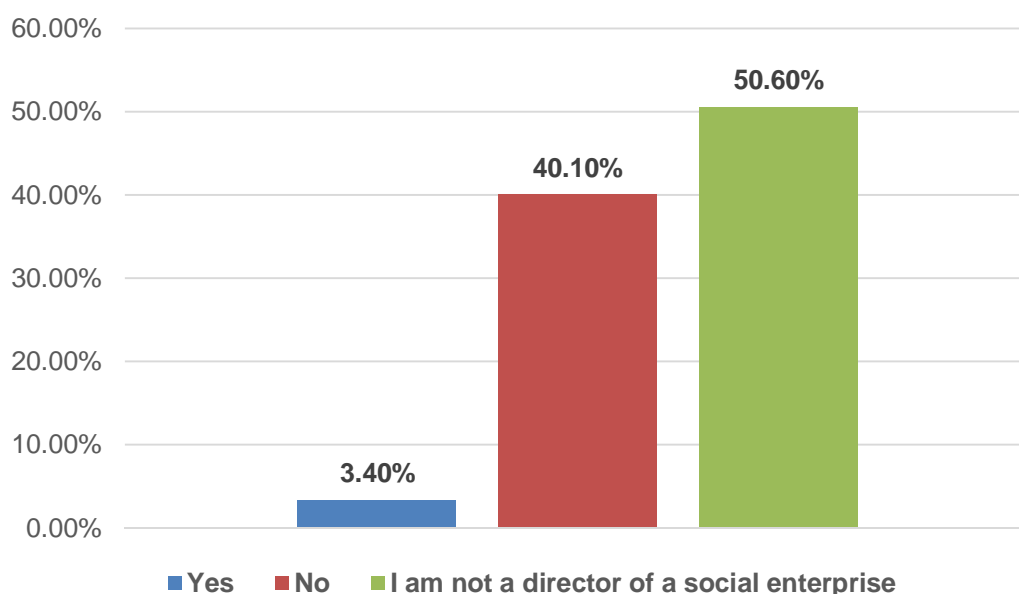
- Directly supporting the development of social impact measurement such as through providing research funding or partnering with participants to create standardised metrics where appropriate;
- Making it clear whether the development of robust social impact evaluation frameworks are approved under government funding contracts (and ensuring that the true cost of these exercises is appropriately recorded and included if it is); and
- Expanding the range of government data available to be used as part of social impact evaluation.

28. Have you faced a legal impediment as a director of a social enterprise from making a decision in accordance with the mission of the enterprise, rather than maximising financial returns, that only a change in the legal structure could resolve? If so, what amendment to Commonwealth legislation, regulation or ASIC guidance would you consider is needed to address this problem?

The AICD has surveyed its members about their experiences to draw out whether they perceive there is a legal impediment preventing them from making decisions that give reasonable consideration to mission-related factors (rather than focusing on maximising shareholder value).

For the purposes of this consultation, the AICD has conceptualised the 'legal impediment' referred to in this question as concerning the operation of directors' duties.

Figure 1: *As a director of a social enterprise, my duties as a director have **prevented** me from making a decision in line with the mission of the social enterprise because I had to prioritise shareholder value.*



Focusing only on those who identify as directors of social enterprises, the results show that very few (**7.8 per cent**) perceived that their duties prevented them from making a decision in line with the mission of their social enterprise because they had to prioritise shareholder value. The overwhelming majority (**92.2 per cent**) did not identify any legal impediment.

Directors duties do not compel directors to make a binary decision between pursuing their mission and maximising shareholder profit. The AICD considers that Australian law already provides flexibility for directors to consider and balance the interests of a range of factors in their decision-making, in furtherance of the enterprise's mission.

The results of our survey indicate that this view is consistent with the experience of directors. The AICD has a strong interest in this area and would welcome the opportunity to consult further on this issue.

29. Would making a model constitution for a social enterprise assist in reducing the costs for individuals intending to establish a new entity? What other standard products of industry-led solutions would assist in reducing the costs for individuals intending to establish a social enterprise?

The AICD considers that a model constitution for social enterprise would be beneficial to supporting the establishment and operation of social enterprises. An approved template would provide some consistency of governance structure across enterprises, and also potentially assist to reduce the cost pressures and complexity of establishment.

This would be particularly useful for demonstrating how a company's purpose can be enshrined within its constitution and protected (such as through the use of a mission lock) in order to provide confidence to investors.

The ACNC provides a template constitution for charitable companies limited by guarantee⁴ which has been well-received by the charity sector. Critical to the success of this tool has been the accompanying guidance which explains how the rules can be used (or not used). As with the example provided by the ACNC, any model constitution should be voluntary.

The AICD recommends that a model constitution be developed and that this is supported by detailed education and guidance materials.

We hope our comments will be of assistance to you. Should you wish to discuss any aspect of this submission, please contact our Policy Adviser, Lucas Ryan via lryan@aicd.com.au or (02) 8248 6671.

Yours sincerely



LOUISE PETSCHLER
General Manager, Advocacy

⁴ Australian Charities and Not-for-profits Commission, 'ACNC's template constitution for a charitable company limited by guarantee', <http://www.acnc.gov.au/ACNC/Pblctns/Guides/ACNC/Publications/CLG_template/TemplateCLG_Landing.aspx> (accessed 23 February 2017)