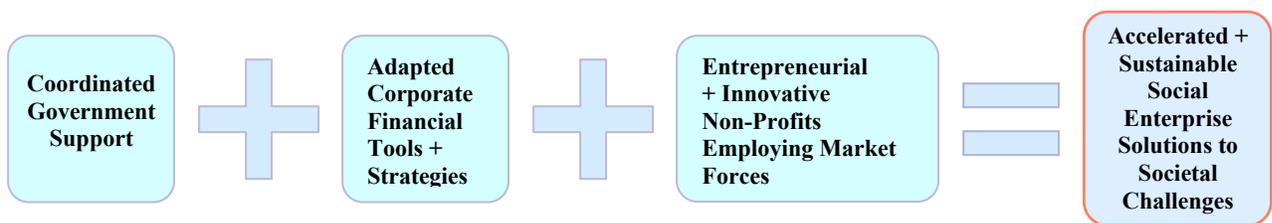


# APPENDIX B

## CAUSEWAY POLICY BRIEF

### SOCIAL FINANCE: Enabling social enterprise for public benefit

December 2008



# **SOCIAL FINANCE: ENABLING SOCIAL ENTERPRISE FOR PUBLIC BENEFIT**

## **Introduction**

Causeway is a national collaboration aimed at growing social finance options and creating a social capital marketplace that will enable enterprising non-profits and social enterprises owned by non-profits and charities to use limited public and philanthropic investment to leverage significant private capital to achieve public aims and significant long-term benefits for Canadians.

**The aim of social finance is to transform the third sector's ability to respond to society's changing needs by enabling greater access to a variety of investment instruments.**

This brief is an introduction to social finance and social enterprise for policy makers. It defines key terms, highlights success stories, frames the opportunity for Canada, and sets out next steps in a course of action that will enable us to realize this opportunity.

Canada's social and environmental sectors are significantly underfinanced and undercapitalized relative to the needs and opportunities before them. They lack both donation and grant revenue to sustain subsidized charitable services **and** investment capital to expand entrepreneurial models of mission delivery.

Enabling access to new sources of capital is critical to their ability to innovate, scale up successful solutions, and extend their services/programs and impact. Government and philanthropy are limited in their capacity to meet this need, particularly in light of current economic conditions, which make the need to find new ways to finance social and environmental innovation even more imperative.

Social finance, and the enterprises it supports, is proving internationally to be a successful way to leverage private capital to generate large-scale public benefits, giving enterprising non-profit organizations the resources and flexibility they need to innovate and expand their impact.

As governments in Canada contemplate significant new infrastructure investments to stimulate the economy and regulatory reforms to our capital markets, institutions and practices, this is an opportune time to consider how we can make parallel investments in our social infrastructure through policy, regulatory, and institutional changes that enable the growth of an effective social capital marketplace that is attractive to institutional and private investors and connects them efficiently to social enterprise investment opportunities.

Causeway and other non-profit institutions are working actively with the investment sector to build social enterprise awareness and capacity among Canada's non-profit organizations. Governments have a critical role to play, however, in creating a policy, regulatory and tax environment that will enable more organizations to launch social enterprises and ensure existing ones have access to the capital they need to grow and thrive.

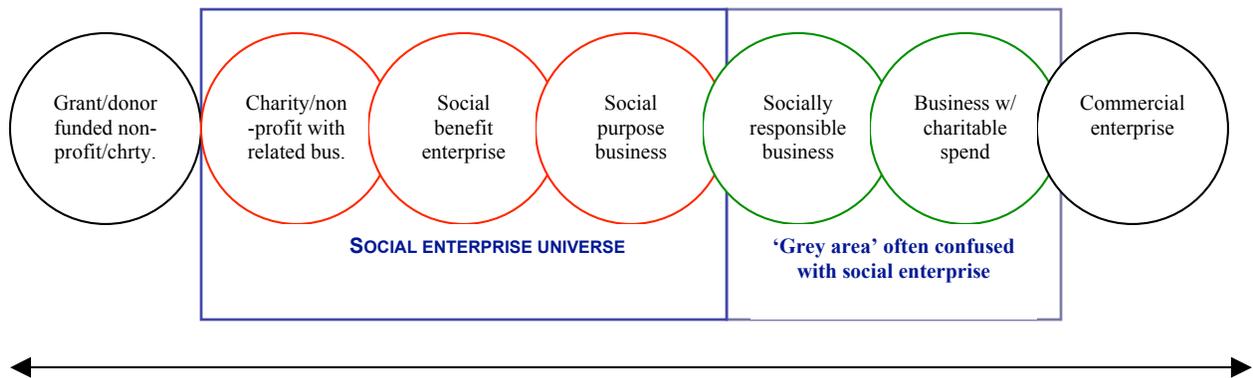
Our collective task is to take a marketplace that is only just emerging and to put in place the intermediary institutions, frameworks and rules that will transform it into a mature and efficient means of connecting private capital with public benefit opportunities. This new marketplace, enabled by new infrastructure investments will deal effectively and efficiently with growing social and environmental challenges.

## What is a social enterprise?

Definitions of social enterprise vary in diverse countries and cultures and with the different organizational forms it has taken in these contexts. With respect to Canada, **a social enterprise is an organization or business that uses the market-oriented production and sale of goods and/or services to pursue a public benefit mission.**

**Social enterprises take many forms**, located on a spectrum between traditional grant-funded charitable or non-profit activity at one end and pure for-profit business at the other.

**Figure 1 The social enterprise spectrum**



Source: Adapted from Venturesome, *Financing Civil Society*, 2008

One of the most common forms of social enterprise in Canada is that of the otherwise traditional **non-profit organization or charity that operates a mission-related business** to generate revenues to support its programs and provide employment/job training opportunities for disadvantaged individuals. While business profits account for a portion of their overall revenues, these organizations also rely heavily on government and philanthropic grants.

Further along the spectrum are **non-profit or limited-profit collective enterprises** established for public benefit that rely primarily on a business enterprise for their sustainability, while still benefiting from some measure of public and/or philanthropic subsidy. These may return a limited profit to investors, but the assets of these businesses are not tradable and governance structures are democratic and member or stakeholder driven, not tied to capital ownership. These include cooperatives aimed at public benefit (e.g. beyond their own membership), micro-finance institutions, and new hybrid company structures such as the community interest company (CIC)<sup>i</sup> established in the UK or low-profit limited liability companies (L3Cs)<sup>ii</sup> recently established in some U.S. states.

At the far end of the spectrum lies the **social purpose business**, established to pursue in equal measure a defined public benefit and economic profit. These are often referred to as double or triple bottom line businesses because they measure their performance in terms of positive social and/or environmental impacts as well as economic profit. Investors deriving positive market-rate or below-market returns from their investments primarily capitalize these. However, in some cases these ventures may enjoy some public or philanthropic subsidy, particularly during the start-up and early growth phases. Social enterprises typically have the following characteristics:

serve a social (or environmental) mission, expend the constituency served, bring value to partners, and generate earned income.

## Why social enterprise matters

**Social enterprise matters because it offers:**

- **Flexible and sustainable financing to support social innovation** – providing public benefit organizations with greater freedom and capacity to test new ideas, refine and adapt them, and expand implementation of those that work.
- **Opportunities to leverage capital on a large scale to address public challenges**, using limited public/philanthropic investment. Leveraged capital could be private capital. Or re-profiled predictable public expenditure.

### *More flexible and sustainable financing to support social innovation*

The limited fiscal capacity of both governments (especially when faced with aging demographics and increased budget share devoted to health) and of philanthropy to keep pace with the increasing scope and complexity of Canada's social, environmental and economic challenges, means that **Canada's voluntary sector must increase its capacity to innovate and find more sustainable ways to tackle programs and services (i.e. through expanded programs, or improved effectiveness and efficiency of delivery models).**

**Social enterprises are critical to meeting this goal** because they are:

- **Innovation driven** – Highly entrepreneurial, flexible, and therefore able to test, adapt, and refine novel solutions that can be taken to scale
- **Focused on impact** – Possessing clearly defined mission goals and accountable for social/environmental impacts as well as profits to a broad base of stakeholders; employing new tools and metrics
- **Sustainable** – Leveraging substantial private and volunteer capital using only limited public/philanthropic investments
- **Collaborative** – Often employing cross-sectoral partnerships and relying on non-profit sector collaboration.

**Canada has a long and successful tradition of social enterprise** in this respect, in its cooperative movement and non-profit sector. **Governments have played an important role in enabling this activity** through supportive grant programs, tax incentives and regulatory frameworks. **More deliberate and comprehensive action is needed, however to remove ongoing barriers to this kind of activity** and to enable more organizations to adopt social enterprise approaches and scale up successful initiatives.

### *Leveraging private capital investment on a large scale for public benefit*

More recently, a **convergence of social and economic trends** has opened up the prospect of **social enterprises mobilizing private capital investment to tackle public challenges on an unprecedented scale** – if the appropriate enabling environment can be put in place.

**Investors seeking to diversify** their portfolios, the rise of **values-driven investors and consumers**, growing **social inequity and environmental crises**, an emerging track record of

**social enterprise successes, talent opting for more values-driven careers, and proliferating policy experimentation** have together set the stage for **a new wave of private investment for social and environmental impact.**

U.S. estimates indicate that, with appropriate regulatory, tax and capacity building measures, **social/environmental impact investment has the potential to reach 1% of all managed assets – making \$619 billion in capital available to U.S. public benefit enterprises.**<sup>iii</sup> The magnitude of this opportunity is apparent when compared to **total philanthropic spending in the U.S –\$3.1 billion.**<sup>iv</sup> There is every reason to believe **a comparable shift can take place in Canada** where 1% of total assets under management<sup>v</sup> would amount to approximately **CDN\$25.7 billion available for public benefit enterprises.**

## **Financing social enterprise**

Financial institutions, governments, foundations, and other investor groups are creating new sources of capital for social enterprises, often called **social finance**. Social finance is **investment in social enterprises** operating in the non-profit or public benefit universe **that delivers blended social/environmental and economic returns.**<sup>vi</sup>

Social finance's **most visible and successful example is global microfinance** (sustainable micro-lending to low-income entrepreneurs unable to access mainstream lending), but it actually embraces a **broad continuum of investment activity between traditional investment vehicles** (high financial and no social return) **and government/philanthropic granting** (no financial, but high social returns).<sup>vii</sup> Currently, the **two primary streams of social finance** are **venture philanthropy** and **social venture capital.**

### ➤ *Venture philanthropy*

**Venture philanthropy**<sup>viii</sup> **combines long-term grant support with management assistance for nonprofit social enterprises.** This approach is well developed in the U.S. where **foundations can use their endowment capital to make Program Related Investments (PRI) and Mission Based Investments (MBI)** to advance a diverse range of philanthropic goals, at varying rates of risk and return. These **investments are accompanied by active involvement and support.** **Charitable endowments in Canada represent a significant a significant potential source of capital** investment for social enterprises. While the Canadian government does not track total charitable endowment assets in Canada, **private foundation endowments are estimated to be \$10 billion**<sup>ix</sup> and **universities a further \$11 billion.**<sup>x</sup>

### ➤ *Social venture capital*

**Social venture capital**<sup>xi</sup> makes debt and equity investments in for-profit organizations focused on both social/environmental impact and financial return. **Social finance products** in this zone include **insured and uninsured deposits, senior and subordinated loans, debt with equity features, loan guarantees, fixed income securities, real estate mortgages, stock purchases and private equity.** This approach is well developed in the UK, with the **introduction of CICs** and a range of **initiatives to develop a more vibrant social capital marketplace.** In the U.S., the recent **introduction of L3Cs** and the **New Markets Tax Credit** are also significant enabling measures.

Venture philanthropy and social venture capital borrow heavily from private sector venture-

capital practices, where **investments are made on the basis of an organization’s history, leadership, and business plan** and typically **run for 3-5 years**. Organizations that meet their business targets can expect follow-on investment for continued growth. **Financing is for an overall plan**, rather than a specific program and is consequently **completely unrestricted**.

**Figure 2 Typology of social finance instruments**

	Grants	Patient Capital	Pure Equity	Equity-like	Loans
Expected loss %	100%	20-50%	10-20%	10-20%	1-8%
Return on investment	0	-50%-c. 10%	No limit	Variable up to 30%	Fixed 5-18%
Term of investment	Often short periods	Repayment holidays	Undefined Depends on success	5-7 yrs Depends on success	Fixed term
Involvement in business	Low (except venture philanthropy )	Some (through partners)	High (through board )	High (through board )	Low
Exit of investment	n/a	Repayment	IPO, sale, buyout	Royalty, repayment or APO	Repayment
Liquidation rights	None	None/subordinate	Residual	Subordinate	First priority
Voting rights	No	No	Through ownership	Structured in loan agreement	No

Adapted from : **Bridges Community Ventures , UK**

**Canada’s non-profit sector is economically significant** and growing. It currently represents **\$120 billion in annual expenditures** – more than Canada’s retail, mining, or oil and gas sectors. With **government and philanthropy reaching their expenditure limits**, however, engaging **private capital represents our best strategy** for growing this sector further **to meet new and expanding public needs or to be more innovative in how we respond to current challenges**. **The sector currently has very limited access to financial tool kit available to the private sector.**

At present, however, **Canada lacks a smoothly functioning social capital marketplace** to enable this investment.

**Many non-profit organizations do not seek alternative forms of capital** because they lack business expertise, are wary of the associated risks of borrowing, or do not have a business model to support debt financing.<sup>xiii</sup> **Regulatory barriers also prevent charities and non-profit organizations from structuring and financing social enterprises on an optimal basis and foundations from investing in non-traditional ways** in these enterprises.

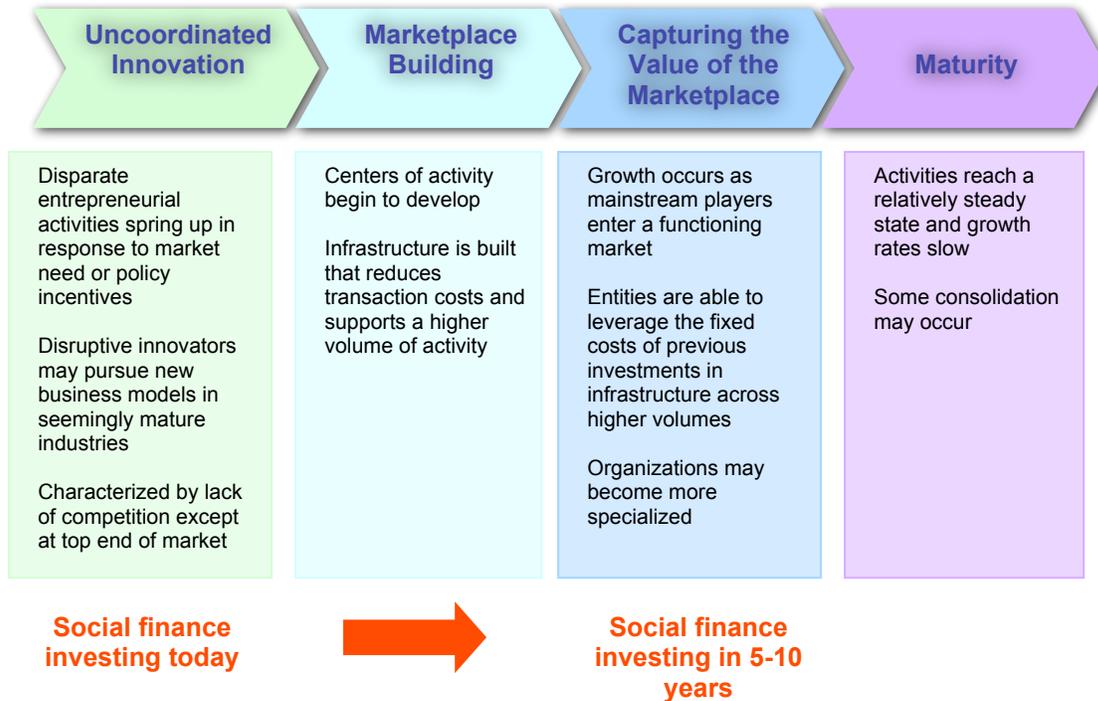
**Private sector investors face additional challenges.** The **absence of effective intermediary institutions** makes it **difficult to classify social enterprise investment opportunities into asset classes and to accurately assess the potential risks and returns** without incurring **excessive transaction costs**. **Lack of tax incentives** or other government-sponsored approaches to mitigating risk also **discourage institutional investors** from participating in this market.

Despite these challenges, sectors like affordable housing and community energy have begun to connect to the private capital market. The goal, however, is to make this process far more efficient and to extend private capital investment opportunities to other sectors.

All new industries face similar challenges in establishing a marketplace, as *Figure 3* below shows. In order **to build an effective social capital marketplace in Canada, we need to move**

from our current stage of uncoordinated innovation and put policies, regulatory frameworks, incentives and institutional infrastructure in place to harness the value social enterprise offers and enable the private capital flows that will drive it.

**Figure 3 Evolution of a new industry marketplace<sup>xiii</sup>**



### Creating an enabling social finance environment

To make this transition successfully, we need to create an enabling social finance environment that:

1. **Removes regulatory barriers** to establishing and operating social enterprises
2. **Builds capacity** in public benefit organizations to participate in social enterprise
3. **Creates an effective social capital marketplace**
4. **Offers incentives for investors to participate**
5. **Provides a locus for ongoing policy dialogue and development.**

**This process is already underway in other jurisdictions**, most notably the **United States** and the **United Kingdom**. Experience in these jurisdictions has shown that **governments play a central and critical role** in facilitating these changes.

The **challenge in Canada is to create a similarly enabling social finance environment** here, **building on our own institutions** and strengths while **adapting innovations** that have proven successful elsewhere.

## APPENDIX A SOCIAL ENTERPRISE AND SOCIAL FINANCE SUCCESS STORIES

### SOCIAL FINANCE AT WORK: EDMONTON SOCIAL ENTERPRISE FUND

Launched in February 2008, the **Edmonton Social Enterprise Fund (SEF)** combines business expertise with **flexible financing** to help Edmonton not-for-profit organizations and cooperatives create or expand strong, **sustainable business ventures and affordable housing projects**.

**Loans for housing projects** are **short term**, may **range up to \$500,000**, are designed to bridge to conventional and other sources of financing, and may be used for **construction, renovation or the purchase of property**.

**Loans for social enterprise** are available for **start-up or expansion** of social enterprises. Loans for start up may range up to \$50,000 and for expansions up to \$150,000. Loans are generally for **terms of 5-8 years** and may be used to finance operating and equipment needs, building purchases and even the purchase of a franchise. In certain limited circumstances, building purchase loans will be made for a term of up to 10 years.

All loans are **near prime and repayable**. The **5-year goal is to secure \$11 million in capital** and to invest this capital in loans to social enterprise and housing projects. **Repayments will be reinvested in other loans** significantly leveraging the lending power of the Fund.  
[www.socialenterprisefund.ca](http://www.socialenterprisefund.ca)

### SOCIAL FINANCE AT WORK: SOCIAL CAPITAL PARTNERS

Social Capital Partners invests in social enterprises that employ populations outside the economic mainstream in Canada, helping them to acquire scale, exist without external subsidy, and create improved social outcomes and financial self-sufficiency for the populations they employ. SCP also hopes to encourage and catalyze other innovative funding mechanisms for social initiatives.

As there are few financing mechanisms available to these organizations, SCP attempts to fill this important gap in the capital market by providing financing for for-profit and not-for-profit social enterprises in the form of loans, equity or near equity, and grants:

- *Loans* – SCP can arrange loans of C\$30,000-\$200,000 to finance the growth of established operations, with the potential for further funding if certain financial and social benchmarks are met. Interest rates vary depending on the size and risk profile of the investment but are typically lower than those offered by traditional financial institutions.
- *Equity / Near Equity* – SCP arranges equity financing for for-profit enterprises and near equity financing for non-profit owned enterprises in the growth phase of operations. Near-equity financing can include subordinated debt, mezzanine financing, convertible debt or preferred debt. In both cases, financing ranges from C\$100,000 to C\$250,000 with potential for further funding if certain financial and social benchmarks are met.
- *Grants* – Grants are not a significant component of SCP's funding framework at this time. In rare circumstances SCP may consider strategic use of grants to establish a sustainable livelihoods results monitoring framework, but only for social enterprises that operate within a registered charity.  
<http://www.socialcapitalpartners.ca/>

### **SOCIAL FINANCE AT WORK: BRIDGES VENTURES, UK**

Bridges Ventures is a privately owned UK fund management company with a social mission. All funds raised must achieve a clear social purpose as well as financial returns for investors.

Bridges established its first community development venture fund in May 2002. *Bridges CDV Fund I* is a 10-year fund of £40m that invests in businesses in the most deprived parts of England. These range from start-ups to small management buy-outs and property-backed ventures. Half of the fund's capital comes from private investment, primarily from banks and pension funds, and half from government investment.

*Bridges CDV Fund I* has made equity investments in 24 businesses employing 700 people, almost 200 of whom came out of unemployment, and has had three successful exits. Founders, directors and investors offer active advice and guidance to companies in the fund, based on their own expertise and that of a network of business contacts and successful entrepreneurs. This includes helping build effective boards.

In 2007 Bridges Ventures raised a second £75m fund, *Bridges CDV Fund II*, entirely from private sector investors. All funds raised by Bridges Ventures have specific strategies to achieve a positive social impact. Bridges reports regularly on the social impact of its investments, as well as their commercial and financial progress.

### **SOCIAL ENTERPRISE AND FINANCE AT WORK: RENAISSANCE QUEBEC**

Renaissance is a charitable organization aimed at the professional and social reintegration of people excluded from the labour market. It accomplishes its mission, in part, by operating a Montreal-based chain of second hand stores called Fripe-Prix. The stores provide affordable clothing and household items to the community while creating employment opportunities for individuals with significant employment barriers. Renaissance is affiliated with Goodwill International.

The goods sold at Fripe-Prix are recovered through a home pick-up system. Donations from individuals and businesses consist mainly of clothing, but the organization also receives furniture, books, toys, small electrical appliances, electronic components, and computers. Renaissance recovers six million pounds of used goods per year.

Social finance organization, Social Capital Partners (SCP), provided the grant and loan financing that allowed Renaissance to launch a new flagship Fripe-Prix store in Montreal. This store is being used to test innovative pricing, merchandising and marketing strategies to improve sales and profitability across the chain. SCP also arranged for Renaissance to receive strategic advice from its partner, The Monitor Group.

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<sup>i</sup> Community Interest Companies (CICS) are limited companies, with special additional features, created for the use of people who want to conduct a business or other activity for community benefit, and not purely for private advantage. This is achieved by a "community interest test" and "asset lock", which ensure that the CIC is established for community purposes and the assets and profits are dedicated to these purposes. Registration of a company as a CIC has to be approved by the Regulator who also has a continuing monitoring and enforcement role

<sup>ii</sup> Low profit limited liability companies (L3Cs) are for-profit ventures that, by legislation, must have a socially beneficial purpose as their primary goal. Legislation creating L3Cs was specifically designed to make them eligible vehicles for Program Related Investments (PRIs) by foundations. L3Cs facilitate layered or 'tranching' investing with PRIs usually assuming the most risk, thereby lowering it for other investors and making investment in the L3C more commercially attractive by improving the capital rating and lowering capital costs.

<sup>iii</sup> Katherine Fulton (Monitor Institute), *The Future of Social Capital Markets*, Oct 2008. PowerPoint presentation delivered by Bill Young, Social Finance Summit, MaRS Centre, Toronto November 18, 2008.

<sup>iv</sup> *Ibid*

<sup>v</sup> Estimated at \$2,563.9 billion. Source: The Social Investment Organization, *Canadian Socially Responsible Investment Review 2006, 2007*. Page 6. Available at: [www.socialinvestment.ca](http://www.socialinvestment.ca)

<sup>vi</sup> Tim Draimin, *Innovation & Social Enterprise: Building Financial Capacity*, PowerPoint presentation AFP Fundraising Day, May 28 2008.

<sup>vii</sup> Tim Draimin and Ted Jackson, *Social Finance – An underdeveloped but essential aspect of sustainable investing in Canada: Building Social Finance Momentum*. Presentation to Social Investment Organization Conference, Montreal, May 29, 2007. Page 3.

<sup>viii</sup> Prominent venture philanthropy groups include: Ashoka, Atlantic Philanthropies, The Blue Ridge Foundation, Draper Richards Foundation, Echoing Green, Edna McConnell Clark Foundation, Great Bay Foundation, New Profit Inc., Robin Hood Foundation, Roberts Enterprise Development Fund, Skoll Foundation, Venture Philanthropy Partners, and Wallace Foundation.

<sup>ix</sup> Scotia Private Client Group, *Overview of Private Foundations*, online:

[http://www.ritceyteam.com/pdf/Overview\\_of\\_Private\\_Foundations.pdf](http://www.ritceyteam.com/pdf/Overview_of_Private_Foundations.pdf).

<sup>x</sup> Amanda Shendruk, *Market crash crushes university endowments*, Macleans OnCampus Nov 24, 2008. Online: <http://www.macleans.ca/education/2008/11/24/global-economic-crisis-takes-heavy-toll-on-canadian-universities/>

<sup>xi</sup> Social venture capital groups include: Acumen Fund, Good Capital, Investors Circle, and the New Schools Venture Fund. In the past 18 months, a **new type of fund** has also emerged that **acts like an investment bank**. These funds include: Growth Philanthropy Network, Nonprofit Finance Fund Capital Partners, and Sea Change Capital (former Goldman Sachs executives).

<sup>xii</sup> Natasha van Bentum and Maggie Leithead, *Strengthening Organizational Capacity - Social Finance Survey Report*. Page 2.

<sup>xiii</sup> Fulton (2008)