



The Social Purpose Capital Marketplace:

An Opportunity for the Canadian Charitable Sector

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Executive Summary

There is growing interest in the opportunity of scaling up social finance in Canada, as a means to foster social innovation and leverage additional capital to advance the social and environmental quality of life. This paper compiles recent thinking on the opportunity of creating a social capital marketplace, with a focus on the role of charitable organizations, both as financiers and recipients of social finance capital. It defines the social capital marketplace within the Canadian context, and lists a number of key drivers and trends towards its creation, from the capital provider, the capital user and the intermediary point of view. The trends analysis concludes that significant capital could potentially be available to finance social innovation given the current and anticipated influx of new wealth donors and socially motivated investors, and a venturesome approach to philanthropy and social development is growing amongst this new donor and investment community. Additional trends noted in the scan include the growth in the social enterprise sector, and the considerable social finance experimentation that is underway in Canada and globally.

The paper next describes the extent and nature of the Canadian charitable sector, using Statistics Canada data, concluding 1) that the charitable sector already derives considerable revenues from its fee-generating activities (i.e. fees for goods and services) and 2) that the sector is asset-rich, holding considerable wealth that could be leveraged for social innovation. The paper goes on to list a number of barriers and opportunities for the growth of the social finance sector, which collectively point to a road map for taking it to scale:

- Map and build out the social purpose capital market infrastructure
- Promote human capital development for social financiers and entrepreneurs
- Develop and implement education, awareness and engagement strategies for capital providers
- Expand capacity-building for capital users
- Construct and advocate for a social finance public policy agenda

The paper concludes as it started, with a proposition that mission-based organizations are positioned to leverage their under-performing assets to scale up social innovation and social finance in Canada.

I. Introduction

The past few years have witnessed significant transformation in the community sector in Canada, with declining government revenues and the emergence of new wealth donors, venture philanthropy, hybrid social enterprises (i.e. non-profit businesses, earned income programs, and social purpose for-profits), social programming innovations and social finance experiments. These trends position the sector – including social economy and community economic development organizations, foundations using their assets to invest in community development, philanthropic and community investors, social venture businesses, etc. – for increased scale and impact, with great potential, if successful, to generate significant long term social, economic and environmental benefits to Canadian society.

The hybridization of social and environmental mission with business enterprise is a global trend, the speed and impact of which is greatly dependent on the degree to which financing is available to capitalize the emergent hybrid ventures. Neither purely for-profit (a sector financed through traditional capital markets), nor purely not-for-profit (financed by donors and governments), the social enterprise sector struggles for legitimacy and impact through a lack of financial instruments and intermediaries that recognize and reward the dual purpose nature of the business. Canada lacks a sophisticated and integrated “social purpose capital marketplace” to provide the critical financing to bring these social value businesses to scale and to realize their potential. It is the position of this paper that if a means can be found to unlock both traditional capital within the banking system and, particularly, the latent capital within the foundation sector a significant volume of new funding can be freed up to finance a new generation of social enterprises.

Tides Canada Foundation and PLAN Institute convened two events over the past 18 months¹, attended by a diverse mix of business, finance and investment, government, social innovation, hybrid social venture representatives and others, to address the potential, opportunities and barriers of a social purpose capital marketplace to advance social transformation. Both sessions concluded resoundingly that greater education and awareness and partnerships between the business, finance and community sectors is critical to move this agenda forward. They also concluded that there is a need for more information on international best practices, demonstration pilots and measurement models such as a social return on investment. Finally, they agreed that the development of a public policy program to facilitate the growth of social finance is essential. Across both meetings participants called for a national effort to develop a strategic plan to create the architecture for a social purpose capital marketplace in Canada. It was recognized that to move public policy and business innovation forward, it was critical to scope out the nature of the Canadian social purpose capital marketplace. This paper is an attempt to do just that, written for Tides Canada Foundation and funded with support from CARE Canada, JW McConnell Family Foundation, and Social Capital Partners, all organizations interested in supporting the growth of the social finance sector in Canada.

The following provides an overview of the social purpose capital marketplace, including a definition, drivers and trends, and the size and scale of the Canadian charitable sector – both financiers *and* beneficiaries of a social finance industry. The paper goes on to identify barriers and gaps to, and opportunities for, growing social finance in Canada, concluding with some thoughts on ways to advance the creation of a Canadian social purpose capital marketplace including possible roles for the charitable sector. The focus of the paper on charities is intentional, insofar as Tides Canada, the paper sponsor and itself a registered charity, seeks to understand and promote the unique perspective of charitable organizations with respect to these growing trends. As such the paper does not address other social enterprise structures including non-profit organizations, co-operatives and for-profit social enterprises which are significant contributors to the social economy.

The paper summarizes perspectives gleaned from key articles written on this topic, as noted in the resource list in Appendix A. The author rolled up the research and insights from a number of sources into this paper, and organized them to address the question of the role of the charitable sector in scaling up the social finance sector. Thus, not all of the language is original and quotes have been used to identify key sources throughout the paper. Additionally, the paper underwent a peer review, in which comments were solicited from social finance practitioners and thought leaders in the field, listed under “Acknowledgements” above.

The emergent and transitional nature of the social finance sector makes it difficult to capture all the issues and contradictions inherent in its growth, a point that was realized through the peer review process. The exercise to

¹ Coro Strandberg, “Over the Horizon” (http://www.tidescanada.org/files/pdf/over_horizon.pdf)

define, assess and scale social finance is necessarily iterative – considerable scoping work lies ahead to perceive the boundaries and opportunities of this effort. Some questions that this paper does not fully address and will no doubt be tackled in future forums, include:

- The extent and nature of the demand for social finance, i.e. documented evidence and quantification of social enterprise capital needs;
- The extent and nature of the market for moderate return, longer term, or higher risk investments;
- The degree to which the social sector would be interested in collaborating to grow their social finance opportunities, and evidence thereof;
- The appropriate role for the public sector versus social enterprises in the provision of social goods; and
- Whether regulatory rather than voluntary approaches should be advanced for motivating social outcomes through capital markets.

This paper begins by examining the definition of the social purpose capital marketplace, and identifying some of the key drivers and trends of its development. It goes on to define and quantify the Canadian charitable sector, and then lists the barriers and opportunities to growth of the social marketplace, laying out a possible roadmap to take social finance to scale.

2. Social Purpose Capital Marketplace Defined

Social historians will debate the origins of the social purpose capital marketplace, but it could be argued that Bangladesh is the birthplace of the modern social purpose capital market, wherein the Grameen Bank pioneered the micro-finance movement, proving that it was financially viable to make very small loans to impoverished women to finance family micro-businesses. Some define the social purpose capital marketplace in very broad terms as the market within which non-profit organizations seek and receive financial support from a variety of donors, contracts, government grants and other sources². For the purpose of this paper, the social purpose capital marketplace is defined as the space on the financial continuum between high financial value and no social value returns (traditional financial investment vehicles) and no financial value but high social returns (grants).

Financial products in this zone (referred to as social finance products) 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. What distinguishes these investments as *social* finance is that they are generating a social (and/or environmental) as well as a financial return, referred to as a double bottom line or blended value investment (or a triple bottom line investment when social, economic and environmental returns are generated). They exist on the spectrum between the +5% return of a conventional fixed income investment and the -100% return characteristic of grants. Also found along this spectrum are financial investments which offer the investor below market returns, while others offer market rates and everything in between.

The social purpose capital marketplace channels financing to social purpose ventures unable to secure capital through traditional sources and often as a stepping stone to conventional finance. These social ventures collectively

² Jed Emerson and Paul Carttar, *Money Matters: The Structure, Operations and Challenges of Nonprofit Funding*, Jan. 2003, p. 7.

make up the social economy, which the Federal Government defines³ as enterprises producing goods and services for the market economy, as with any business, but where their operations are managed and their surpluses directed in the pursuit of social and community goals. Social enterprises are structured to:

- o stimulate job creation and skills development;
- o enhance community capacity for social supports;
- o support economic growth and neighbourhood revitalization;
- o protect and regenerate the environment;
- o improve social capital (here in the context of trust and reciprocity per Robert Putnam); and
- o mobilize disadvantaged groups.

They could be for-profit subsidiaries of non-profit organizations, designed to generate a revenue stream to finance social programs, or they could be non-profit structures with a mission to provide benefits and employment to disadvantaged groups and sectors including community loan funds and conservation financing. Asset development initiatives of non-profits such as buying buildings and creating endowments and for-profit businesses with overarching social and environmental goals are included within the social enterprise sector.

Fundamentally, the social purpose capital marketplace mirrors the traditional capital market system, the means by which long-term debt and equity securities are bought and sold by companies, governments and other organizations either directly or through intermediaries. For the efficient functioning of social purpose capital markets, the social finance industry needs to replicate or infuse the infrastructure of traditional finance, which has been evolving for the past few hundred years. While the lack of financial sophistication poses an obvious developmental challenge to the social finance sector, the pre-existing architecture of the financial capital marketplace provides a useful roadmap for scaling up social finance for social innovation in Canada. Further, other jurisdictions, particularly the US, have more advanced social purpose capital markets, as reviewed in the drivers and trends below. Their more mature social finance industry provides a template and best practice database which can be readily built upon for the benefit of the Canadian social enterprise sector.

As demonstrated by the Bangladesh-based Grameen Bank illustration that heads this section, social finance can flourish anywhere under the right market conditions. Indeed, a Canadian social capital marketplace can raise financing for either domestic purposes or for Canadian-led development efforts overseas.

³ http://www.sdc.gc.ca/en/cs/comm/sd/social_economy.shtml

3.

Drivers and Trends of the Social Purpose Capital Marketplace

There are three main actors in the social purpose capital marketplace which are driving its emergence and positioning it for growth: capital providers, capital users and the intermediaries and brokers of capital. Collectively these actors are transforming the landscape of non-profit finance.

Capital Provider Trends:

- **New wealth and venture philanthropy**

A new breed of capital providers – donors and investors – are entering the scene and influencing the development of the social purpose capital marketplace. Rapid wealth creation on a global scale produced 691 billionaires by 2005, a nearly 65% growth from the previous decade.⁴ Much of the new wealth is self-made, from innovators in the traditional private sector, whose approach to philanthropy is more businesslike and who are seeking results-based impacts or social returns on their investments. This emerging field of philanthropic investment, referred to as venture philanthropy, applies the practices of long-term engaged investment of venture capital models in the for-profit sector to the development and financing of social purpose enterprise. This includes not only financial investment, but technical assistance and capacity building, multi-year and tailored financing, and shared risk.⁵ Indeed, venture philanthropy is highly risk-oriented, unlike traditional foundation and government grant funding which is risk adverse. These venture philanthropists are hoping that the market discipline they bring to their social investments will result in a productivity revolution in the social sector, helping the sector achieve scale, durability and impact. Venture philanthropy is moving the donor community away from transactional or cheque-book giving, towards transformational investment approaches.

The impact of this shift is expected to be significant with the anticipated intergenerational transfer of wealth predicted over the coming decades. While statistics are lacking for Canada, US estimates are that baby boomers and their parents will transfer wealth and other assets worth at least US \$41 trillion dollars to family members and charities over the next 50 years.⁶ In Canada there is a rumoured one trillion dollars, although some analysts believe that, based on the average of less than one percent of annual wealth that shifts between Canadian generations each year, the amount is actually closer to \$200 billion than \$1 trillion.⁷

- **Growth of the socially responsible investment sector**

Both Canadian and US socially responsible investment (SRI) sectors are growing considerably, in the US particularly. There is an estimated \$3 USD trillion in SRI assets globally⁸ within funds that integrate social and environmental considerations, conduct shareholder advocacy on social, environmental and governance concerns, and make community investments to advance local development. As the Canadian Social Investment Review reported⁹, as of 2004 there were \$65.46 CDN B in SRI investments, up 31% from 2000, of which \$546 M is found within the community investment (CI) sector, including investments that finance poverty alleviation, community

⁴ The Economist, *A Survey of Wealth and Philanthropy*, p. 3.

⁵ NESsT definition at <http://www.nesst.org/>

⁶ Boston College Centre on Wealth and Philanthropy: http://www.lexisnexis.ca/about/releas_details.php?id=36

⁷ See: <http://en.50plus/display.cfm?documentID=7500&CabinetID=329&LibraryID=104>

⁸ See: http://www.thebanker.com/news/fullstory.php/aid/465/Encouragement_for_emerging_markets_.html

⁹ See: <http://www.socialinvestment.ca/publications.htm>

and co-operative development and environmental regeneration and conservation. In contrast to the Canadian CI sector, the US has witnessed an explosion of community investing over the past decade, testament to the impact focused efforts to scale the social finance sector can have. The recent 10 year review of community investing trends in the US, compiled by the US Social Investment Forum¹⁰, revealed that since 1995 community investment has grown from \$4 billion USD in assets to \$19.6 billion USD in 2005, a growth of 388%. This phenomenal growth is attributable to the increased number and capacity of community finance intermediaries, improved information architecture, government tax incentives, and public education and awareness of the community investment opportunities, all of which are on the radar of social finance professionals in Canada.

Additionally, the US Community Reinvestment Act, which compels American financial institutions to contribute to community development finance, has played a big part in the ongoing growth of the American community investment sector.

It is anticipated that these community investment trends will manifest among mission-based organizations and asset managers such as foundations, churches and asset-rich non-profits such as hospitals, educational institutions and others. While the Canadian CI markets have been slow to evolve in this space, developments south of the border are promising.

- **Mission-Based Investing**

Mission-based investing is the incorporation of an institution's mission into its investment decision-making process, where the organization's mission statement serves as a guide in determining what, if any, non-financial objectives it may set for its portfolio. Mission-based organizations that seek to improve societal or environmental conditions are waking up to the opportunity of using their assets in a more engaged way, an approach referred to as total capital asset management¹¹.

Foundations, particularly, can benefit from this perspective. Canadian foundations allocate a minimum of 3.5% of their capital in pursuit of their entire social mission through grants, while 96.5% of capital assets are managed in pursuit of financial value, with typically 0% consideration of social mission. This bifurcation of goals can be addressed by a "unified investment strategy" (UIS)¹², defined as an investment strategy that makes use of both philanthropic and core asset investments to maximize the blended value of those investments. A UIS views grants, below market-rate loans and market-rate investing as various tools to be used in the pursuit of a single value proposition – one that seeks to maximize economic, social and environmental value across all the organizational bottom lines. In this approach, investors view their overall investment portfolio as a single body of investments – not simply as financial investments on the one hand and charitable gifts on the other.

In the US, a number of foundations (with a disbursement quota of 5% as compared to Canada's 3.5%) are adopting asset allocation strategies that set targets or caps for investing their endowments in double bottom line investments, ranging from 1 – 3 % for large foundations to up to 40% of assets for smaller more entrepreneurial foundations.¹³ These investments can be below market loans or loan guarantees or equity investments (e.g. stock purchases in social purpose businesses and partnership stakes in community venture capital and micro-finance funds)¹⁴. Called Program-Related Investing, or PRIs, this approach to investing is relatively small in the US, but growing. Research

¹⁰ See: <http://www.communityinvest.org/>

¹¹ See: <http://www.blendedvalue.org/publications/additional.html>

¹² See Jed Emerson. "A Capital Idea" for a discussion of Unified Investment Strategy methods

¹³ Mark Kramer and Sarah Cooch, *Investing for Impact*, p. 4.

¹⁴ Neil Carlson, *Program-Related Investing Skills and Strategies for New PRI Funders*, p.2

by the US Foundation Centre which undertakes periodic surveys of program-related investment reveals that in 2003 255 foundations were active in PRIs, compared to over 61,000 foundations active in the US that year¹⁵. However, PRI-invested foundations report myriad benefits of PRI investing and efforts are underway to scale up PRI approaches in the US, suggesting likely growth in this field over the coming decade. Benefits of PRI programming include:

- the opportunity of using a new set of tools to achieve impact (e.g. PRIs can stimulate business-based solutions to social problems, especially where a grant is an inappropriate intervention);
- an ability to access funds beyond the normal grant budget (both principal and income can work for charitable ends, while a PRI can also leverage other financing);
- ability to preserve foundation assets by “recycling” funds (grants pay-outs are lost to the foundation while PRIs return the capital); and
- asset diversification, where PRIs can be used to reduce portfolio volatility or increase investment returns¹⁶.

Additionally, while grant contributions can create recipient dependency, PRI investing can foster the internal capacity of borrowers required to build up their financial and management skills while also enabling asset acquisition of organizations to secure longer term sustainability. (The regulatory environment for Canadian foundations differs from the American system in that US charity rules permit a broader interpretation of charitable purposes allowing for more innovation in the areas where charities are appropriating market mechanisms for public benefit. Thus the US has a much more developed social finance universe with a broad range of enabling programs supported by foundations and individual philanthropists. Other reasons account for these differences including a more entrepreneurial environment and lower non-profit dependence on government funding in the US.)¹⁷

While there are many practical benefits of program-related investing, it is perhaps values-alignment which will be the biggest driver of capital into the social venture sector as more and more mission-driven asset-rich organizations, including foundations, churches, non-profits, hospitals, universities, unions, SRI mutual funds, credit unions and others see community investment as a high impact social change tool. For these opportunities to be realized, however, social purpose capital users will need to scale up their operations and capacities and a social finance industry will need to be developed.

Other sectors, too, are poised to consider a role in double bottom line investing, including Canadian pension funds, collectively holding over \$700 billion in assets, religious organizations, First Nations organizations, universities, and non-profits themselves.

Capital User Trends:

• Growth of Social Enterprises

Social enterprises, which pursue social and financial goals, are an emergent sector in Canada and internationally. Sometimes referred to as the social economy sector, there have been recent efforts to define and quantify the size and scale of the industry. In Quebec, for example, there are over 6,200 social economy enterprises that together employ 65,000 people and generate annual sales in excess of \$4 billion¹⁸. A 2003 study identified over 3,000

¹⁵ Margaret Bolton, *Foundations and Social Investment*, p. 9.

¹⁶ Kramer and Cooch, p. 4.

¹⁷ See: http://www.cra-arc.gc.ca/E/pub/tg/rc4143/rc4143-e.htm#P426_50299

¹⁸ Nancy Neamtan and Rupert Downing, *Social Economy and Community Economic Development in Canada*, p. 9.

community-based organizations involved in community economic development, combining social and economic development activities within Canada¹⁹. Social enterprises are not a new form of endeavour: for years museums and art galleries have operated gift shops to support their programs, others such as the YMCA and YWCA charge fees to support their charitable activities, while thrift stores generate revenues and provide low-cost client goods. According to the Enterprising Non-Profits Program in BC, a financing and resource centre for social enterprises, there are three major reasons why non-profits and charities have started enterprises in recent years²⁰:

- diminished government funding;
- the understanding that there are some needs the market will never meet on its own; and
- the opportunity to advance mission-related goals.

Additional reasons include the need to augment funding to meet growing societal needs and the desirability of diversifying funding to reduce dependence on individual funders.

The decade has also witnessed increased financing and capacity-building programs for the social enterprise sector, of which the Enterprising Non-Profits Program is a prime example. The Federal Government brought attention to the sector in its 2004 Budget when it announced \$132 million for initiatives to support the social economy, including research, capacity building financing and improved access of social enterprises to programs and services for small- and medium-sized enterprises.²¹ While it is unclear if the current Federal Government will maintain this focus, nonetheless, the sector stands to gain from this increased attention. Globally the social enterprise sector is experiencing considerable interest both as an antidote to globalization, where economic determination is vested locally, and as an anti-poverty and environmental regeneration tool. For example, several OECD countries have developed strategies to promote social enterprises and the European Union includes the social economy in its entrepreneurship pillar. Major foundations including Ashoka and Skoll are investing heavily in advancing the growth and prospects of the social enterprise sector.

• **Cost of Capital Allocation**

Another driver of the move to social enterprise development, as a means of advancing social mission, is the growing awareness of the cost of capital allocation. Recent research in the US and UK has highlighted the problematic nature of current fund-raising practices and relationships which can be as high as 50%²² compared to rates as low as 2 and 3% in conventional finance. Looked at as an investment market, the social purpose capital marketplace is ten times less efficient structurally. As these ironies are better understood and the gaps closed, intermediaries offering brokerage in the social purpose capital markets will grow apace.

Infrastructure and Intermediary Trends:

• **Investment Infrastructure**

In order for the social purpose capital marketplace to achieve scale and realize the benefits of social enterprise, investment infrastructure will need to be established to support its growth. There is a nascent discussion underway in the Canadian CED and social enterprise/economy communities, which is part of a global dialogue amongst the SRI investment industry, the World Economic Forum, the micro-finance sector and others looking to bridge this

¹⁹ Ibid., p. 10.

²⁰ See: <http://www.enterprisingnonprofits.ca/>

²¹ See: http://www.sdc.gc.ca/en/cs/comm/sd/social_economy.shtml

²² Arthur Wood and Maxmillian Martin, *Market-Based Solutions for Financing Philanthropy*, p. 2.

gap. It is expected that the coming decade will see rapid expansion of this infrastructure, including social stock exchanges, social investment banks and asset management, private banking, brokerage and distribution channels, consulting, data services and research houses.

- **Social Finance Instruments**

Similarly, considerable research and experimentation is underway in the development of blended value financial instruments, which replicate the features of conventional products with an embedded social value component. Various risk/return considerations of different investor segments from fiduciaries to high-net worth individuals will be incorporated into the development of diverse sectoral and geographic community investment opportunities leveraging a range of social and environmental outcomes.

In order to better understand the opportunities ahead for the growth of a thriving Canadian social purpose capital marketplace it would be informative to consider the size and scale of the charitable sector in Canada, significant prospective investor and investee communities poised to launch a new generation of social innovation. The charitable sector (both granting foundations and operating charities) has a key role on the frontlines of innovation, as an “R & D” incubator for practical ways that society can meet and overcome evolving challenges in the social and environmental arenas. Social finance is increasingly recognized as a needed adjunct to other sources of charitable funding (such as receipted donations, which only account for 6% of charities revenue), in order for charities to enhance their impact and sustainability.

4. Canadian Charitable Sector Description

Canadian charities and non-profit, voluntary organizations are amongst the primary beneficiaries and financiers of the social purpose capital marketplace. To realize the potential of this sector to advance the development of the social marketplace, it is important to have an understanding of the nature of the sector itself.

Nature of the Charitable Sector:

Non-profit and voluntary organizations are defined as organizations that meet the following criteria:

- Non-governmental
- Non-profit distributing
- Self-governing
- Voluntary (benefit to some degree from voluntary contributions of time or money)
- Formally incorporated or registered under specific legislation²³.

Registered charities include places of worship (the largest category of charities), social services organizations, health and health care organizations such as hospitals, private and public foundations and teaching institutions (e.g. colleges and universities).

²³ Statistics Canada, *Cornerstones of Community*.

Scale of the Charitable Sector:

Recent federal surveys of the non-profit and voluntary sector documented 82,000 charities from a total pool of 161,000 non-profit and voluntary organizations. 2003 revenue of Canadian charities totalled \$70 B, 18% of which is in gifts and donations, or \$12.6 B; 16.3% of which is fees for goods or services (\$11.4 B), the latter providing an indication of the entrepreneurial nature of the charitable sector. 54.0% of charitable revenue is from government, including payments for goods and services and grants and contributions²⁴. Overall charitable sector assets are deemed to be in the order of \$100 B, indicative of the collective wealth that could be levered for greater social change and innovation with the right stimulus in place.

Scale of the Foundation Sector:

There were 8,954 registered foundations in 2005 (less than 1/3 are active), with \$13.8 B in combined assets (2005)²⁵. In 2003, nonprofits and voluntary organizations, including charities, received \$1.1 B from fundraising organizations, family and public foundations, little more than one percent of the revenues of the charitable sector²⁶.

It is one of the purposes of this paper to pose the question as to how foundation assets can be mobilized to generate higher social benefits. From a total capital asset management point of view, how can Canadian foundation assets be engaged to work harder? Currently these endowments are organized along a single bottom line which is to generate financial returns on the portfolio. Looked at from a double or triple bottom line perspective, and considering the trends and drivers for a more active social purpose capital market described in this paper, how can social and environmental returns be created in addition to financial returns? As can be seen from the foregoing analysis, there is an over-dependence on a relatively small set of funders, thus external factors such as government cuts and policy changes can have a disabling impact on the social sector. How can the social sector isolate itself from these factors, increase the range of financing options available to it and foster an innovation and results-based culture for greater social impact, scale and durability?

The balance of this paper will turn to discussing the barriers to, and opportunities for, scaling up the Canadian social purpose capital marketplace, with a focus on the role of the charitable sector.

²⁴ Statistics Canada, p. 28.

²⁵ See: Philanthropic Foundations of Canada, <http://www.pfc.ca/>

²⁶ Statistics Canada, p. 27.

5.

Barriers to Social Purpose Capital Marketplace Growth

Canada lacks a dynamic and efficient social purpose capital market to create new sources of income and increase overall financing to enable the community sector to take social innovation to scale. The following are some of the key barriers faced by capital providers and users and the intermediation gaps to advancing social finance in Canada.

Capital Provider Barriers:

Capital providers – those with capital to invest in community development, whether individuals or asset managers – confront the following barriers to their participation:

- **Low awareness:** there is an overall lack of awareness and understanding regarding community investment opportunities on the part of potential investors.
- **Poor information:** the prevailing belief amongst potential community investors is that all CI investments are concessionary and high risk.
- **Risk and return issues:** the CI sector lacks a track record and the relation between risk and various returns is unclear. The sector struggles with poor risk mitigation and low returns, a result of its under-capitalization and lack of operating capacity.
- **High transaction costs:** the sector's small deal size results in higher transaction costs – products that require special handling result in slow adoption.
- **Limited financial proposition:** a charitable tax deduction is the only financial value proposition available to individual donors wishing to invest in social enterprises. While there are tax incentives for other sectors, such as labour-sponsored venture capital funds, film and oil and gas, the social enterprise sector does not enjoy similar tax credit status.

Capital Provider Barriers Specific to the Foundation Sector:

The following are some barriers foundations confront when contemplating social enterprise investments:

- **Regulatory and fiduciary issues:** uncertain regulatory and fiduciary mandates for double bottom line investments, including a lack of trustee education and awareness.
- **Cultural issues:** foundations place a heavy emphasis on start-up and innovation funding rather than long-term sustainability and capacity development of non-profits. Their primary focus is on project and program financing as opposed to organizational development, with a one-size-fits-all mentality: the grant as the sole means of program financing.
- **Staff resources:** foundation staff lack the dedicated resources, time, skills and expertise to engage in social enterprise finance. There are few resources and tools available in Canada to promote CI or PRI roles to foundations and their leadership.

Infrastructure and Product Barriers:

Capital providers unimpeded by the foregoing barriers face a lack of institutional supports to facilitate their engagement, including the lack of developed infrastructure, and limited product availability, as outlined below²⁷.

- **Lack of developed infrastructure** found in traditional capital markets:
 - o **Institutional systems:** the social purpose capital market has an undeveloped institutional system, relative to the traditional marketplace which has a number of established roles, including investment bankers, brokers, traders, salespersons, investment advisors, institutional investors, research firms, rating agencies and other industry-wide resources. Few intermediaries exist to direct investment capital from would-be investors to innovative social initiatives; banking systems to provide platforms to channel and direct capital flows are lacking. In addition to these systems and relationships there is also a need for a compensation scheme for financial advisors and broker/dealers without which community investment will languish as a serious option, especially at the retail/individual investor level.
 - o **Information exchange technology platforms:** there is a need for information systems to facilitate rapid information exchange and enable quick transactions. Currently the sector struggles with poor transparency and reporting systems and limited third-party information, constraining information flows and credibility. There is a lack of performance data and product knowledge for the few CI products that do exist – motivated community investors would find it difficult to identify opportunities with the social and financial features they seek.
 - o **Standardization:** given the early-stage nature of the community investment industry, there is a lack of standardized documents, procedures, protocols, methodologies, definitions and investment vehicles, limiting performance benchmarking and comparisons in the sector. In the absence of standards and benchmarks, investor due diligence is cost-prohibitive.
 - o **Intermediary capacity:** many existing intermediaries such as community loan funds are capacity-constrained and undercapitalized. They struggle for lack of consistent operating support. Mostly small funds, they are under-skilled, with a modest track record and a limited regional focus; they lack reporting infrastructure and customer service capacity.
- **Lack of financial instruments:** Unlike capital markets which have a myriad of financial instruments, social purpose capital markets have been primarily limited to grant financing. While the traditional capital markets boast a variety of financial sources (banks, venture capital, private equity funds) and financial instruments (bonds, equity, loans, etc.) to capitalize various stages of enterprise development (start-up, expansion and continued growth), the social purpose capital market has relied on a single financial instrument and value proposition – a grant-donation – to finance all types and stages of community organization.

Capital User Barriers:

The non-profit sector faces a unique set of constraints in its ability to exploit the opportunities of social change financing, primarily a function of the current market incentives which mitigate against social finance innovation²⁸:

- Heavy dependence on short term, project-based funding takes attention away from longer-term, strategic development of their organizations and missions.

²⁷ Coro Strandberg and Brenda Plant, *Scan of the Community Investment Sector in Canada*, p. 27

²⁸ See: <http://www.nsst.org/>

- Over-reliance on philanthropic fund-raising strategies versus a wider, more holistic approach to organizational financing strategies.
- A focus on diversifying fund-raising sources (e.g. individuals, foundations, corporations and governments, etc.) rather than diversifying types of financing.
- Weak balance sheets from which to lever commercial financing. Grant terms and conditions frequently constrain non-profits from acquiring hard assets or carrying over liquid assets from year to year.
- Limited risk-taking orientation. Traditional grant financing tends to be conservative and program-based. Few incentives exist to take risks or try new solutions because failure can result in funding withdrawal.
- An antiquated charity regulatory regime which discourages innovation and managed risk-taking.

Additionally, non-profits confront capacity issues including fund-raising difficulties, board recruitment challenges, entrepreneurial skill gaps, etc.

The foregoing capital provider, user and infrastructure barriers conspire to seriously limit the ability of the social purpose capital market to achieve its full potential, significantly curtailing the ability of the social sector to maximize economic, social and environmental value. However, the following opportunities suggest a framework for how social finance could be brought to scale with concerted, collaborative effort.

6. Opportunities to Grow the Social Purpose Capital Marketplace

The development of the Canadian social purpose capital marketplace is already underway. Much is in infancy, but with the right signals and efforts the social capital marketplace can be brought to scale. Credit unions and the community investment sector through the Canadian Community Investment Network²⁹ are organizing to create a strong foundation for community investing and social enterprise development. The Canadian Social Investment Organization³⁰ and the CED and social economy sectors are documenting the size and scale of community investing and social enterprise programming³¹. Tides Canada Foundation, Plan Institute, Social Capital Partners, CARE Canada, JW McConnell Family Foundation, and others are coordinating their efforts to identify opportunities to establish a social purpose capital marketplace. This paper is an attempt to contribute to that dialogue. The following are some initiatives that could help position the social finance industry for growth and opportunity, which would go a long way to overcome the barriers listed above.

1. Map and build out the social purpose capital market infrastructure:

- Research potential investor profiles for product development and document existing and potential product opportunities for individual and institutional investors with a range of risk-return profiles and financial structures suitable to the social enterprise market. Develop facility(s) for product manufacturing to fill product gaps.
- Explore the creation of a new “social finance” asset class.

²⁹ See: www.communityinvestment.ca

³⁰ See: <http://www.socialinvestment.ca>

³¹ See: Neamtan and Downing, *Social Economy and Community Economic Development in Canada*.

- Identify existing intermediaries and opportunities for their growth and development including capitalization and capacity-building.
- Explore opportunities for fund of fund structures, secondary financing vehicles and syndications.
- Replicate (or infuse) the traditional capital market infrastructure, including common terminology and standardized documentation, transparency, adherence to standard accounting practices, third party regulation, investment rating services, fund comparison data, distribution systems, insurance and secondary market liquidity, etc.³²
- Develop common social outcome measurements.
- Establish an information clearinghouse that tracks best practice and social finance developments for synergy-maximization, replication and institutionalization.

2. Promote human capital development for social financiers and entrepreneurs:

- Support leadership development and capacity building of social financiers and entrepreneurs.
- Assist cross-sectoral inquiry and learning.
- Provide opportunities for networking and mentorship amongst social finance professionals and social entrepreneurs for problem solving and capacity building.

3. Develop and implement education, awareness and engagement strategies for capital providers:

- Develop an outreach strategy to increase mission-based organization engagement in social finance, including foundations, churches, unions, universities, co-operatives, credit unions, SRI mutual funds, non-profits and others.
- Develop an education and awareness campaign for SRI investors and high net worth donors, perhaps modeled after the US Community Investment campaign. Create networking platforms and venues for retail investors to learn from one another and collaborate on social venture finance opportunities.

4. Expand capacity-building for capital users:

- Identify key constraints of non-profits and charities in developing social ventures that advance their mission and develop capacity support programs to scale up entrepreneurship in the sector (e.g. education and awareness, training, mentorship, seed funding, etc.)

5. Construct and advocate for a social finance public policy agenda:

- Develop a collective industry program to promote a policy environment that encourages social finance efforts in Canada, including a favourable tax and regulatory scheme.
- Expand the definition of fiduciary responsibility to include financial and mission-stewardship for mission-based trusts.

The starting point for advancing this five-point development agenda could be to document and review past practice and efforts and current successes in the various channels of social finance programming to capture lessons and identify synergies. There has been considerable social innovation in Canada to date, which could be engaged and coordinated for greater effect. Indeed, the fledgling Canadian social finance industry is positioned for growth over the next few years. By building out social finance infrastructure, supporting human capital development, facilitating engagement of capital providers, particularly SRI and mission-based organizational investors, building non-profit enterprise capacity and advancing a public policy agenda, social finance will be able to capitalize a new generation of high impact social innovation.

³² Jed Emerson and Josh Spitzer, *Blended Value Investing*, p. 62.

8. Conclusion

There is growing recognition that progress in our efforts to tackle conditions of poverty, disease and environmental degradation given our limited philanthropic resources, will require harnessing all the philanthropic assets at our disposal. The charitable sector has socially underperforming financial assets (reserve funds, real estate, etc.) that could be leveraged for greater social and environmental returns, while social innovation is underfinanced due to the lack of an entrepreneurial risk-based culture in the social sector and the absence of a dynamic social purpose capital marketplace, as outlined in this paper. In addition, foundation and operating charities could leverage non-charitable capital to greater advantage.

To better understand the opportunities ahead, future research could explore the role of co-operatives, for-profit social enterprises and other forms of social economy structures which all have a place in the social finance marketplace. Their contributions to addressing deep-rooted social and environmental issues across the country are no less significant.

Indeed, the way forward for Canada would be for the fledgling social finance industry, consisting of social purpose capital providers, users and intermediaries, to map the gaps, barriers and opportunities to institutionalize the social purpose capital marketplace and advance high-impact social venture development. This brief overview points to a number of challenges and opportunities that lie ahead, but recognizes there is considerable best practice in Canada and internationally to help develop a robust roadmap for growth. Mission-based organizations generally and foundations, particularly, are poised to unleash billions in financial assets with the right market and public policy signals and education and awareness programs. The coming period promises to be a time of great innovation and impact as the Canadian social finance sector matures to fulfill its social change potential.

Note: Information on strategies for scaling up the Canadian social finance sector can be found in meeting notes from a session held in Vancouver, Oct. 19 – 20, 2006 at: <http://www.tidescanada.org/cms/page1090.cfm>

Appendix A

Key Resources

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