

Social Innovation Generation and the MaRS Centre for Impact Investing 2012 Submission to the House of Commons Standing Committee on Finance

Re: Study of Charitable Giving

Executive Summary

Charities and non-profits need ways of raising capital to fund their operations that is complementary to fundraising. Earned-income through the sale of goods or delivery of service is the only increasing source of revenue for non-profits, yet the current rules governing these organizations does not allow for enterprising models of revenue generation. The Canadian Task Force on Social Finance has provided recommendations to: strengthen and grow the space for social enterprise; mobilize new sources of capital; modernize legal and regulatory frameworks; and provide new tax incentives. Progress continues to be made on these recommendations.¹ In the 2011 Federal Budget, the government recognized the contribution of the Task Force and said that it “will consider opportunities to leverage social venture financing through innovative partnerships that can demonstrate cost savings while maintaining or enhancing service levels.”

Background

The House of Commons Standing Committee on Finance’s study of charitable giving in Canada can mark a watershed in the development of Canada’s charity and non-profit sector.

The pivotal role played by Canada’s charities and non-profits is under threat if the economic model that sustains them isn’t allowed to evolve to adapt to the changing fiscal, social and environmental context. The traditional capital model for charities, focused on fundraising and government grants and contributions, is grossly inadequate to meet 21st century needs.

Social Innovation Generation (SiG) and the MaRS Centre for Impact Investing (CII), on behalf of the Canadian Task Force on Social Finance², are committed to the adoption and implementation of systemic changes that unleash the social entrepreneurial potential of Canadian charitable and non-profit organizations to sustainably expand their positive social impact. We envision a more robust, higher impact charity sector significantly growing its ability to turn its social service delivery expertise into new ways to tackle the causes of persistent social and ecological challenges.

Social Impact Context in Canada

Canada’s charities and non-profits are rapidly changing.

While at one time the sector might have been thought of as the preserve of traditional, donor-financed institutions providing a standard range of services, many of today’s non-profits are propelled by social entrepreneurs and social innovators. They are moving beyond a zero-sum model of donations-in, services-out to new strategies employing hybrid mechanisms and market forces to create a range of ingenious ways of growing community value.

¹ See December 2011 progress report for an update: www.socialfinancetaskforce.ca

² The Task Force is composed of business, public-policy, and philanthropic leaders who are concerned about the lack of capital available to address pressing social needs. It is chaired by Ilse Treurnicht (CEO MaRS) and its members are Tim Brodhead (former President, McConnell Family Foundation), Nancy Neamtan (President, Chantier de l’economie sociale), Tamara Vrooman (CEO Vancity), Bill Young (President, Social Capital Partners), Sam Duboc (Founder Edgestone Capital),

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<http://socialfinance.ca/taskforce>

Unfortunately the out-dated regulatory and financing model for the sector is falling further behind the sector's needs. Mounting financial pressures are bringing these issues to a crisis point.

No one statistic captures these pressures. At a macroeconomic level, grants and contributions from government and donations from individuals to charities have plateaued or are decreasing. Yet environmental degradation and an aging demographic relying on growing social services require additional investment. Despite this, social service organizations are asked to maintain or increase current levels of service with reduced financial resources just to maintain the status quo. Instead of being enabled and encouraged to tackle root causes of forestalling social and ecological ills, too much time and resources are trapped in a vicious cycle of managing symptoms.

Across Canada policy makers are recognizing the societal risk inherent in the precarious charity environment and are proposing enabling changes. Here are some very recent examples:

- Alberta's Premier Alison Redford came to power with a platform calling for a \$300 million community investment fund including increased funding for new social enterprises and the exploration of new models of finance, such as Social Impact Bonds, that encourage private investment for non-profits.
- British Columbia's Premier Christy Clark received draft recommendations in November from the government-appointed BC Advisory Council on Social Entrepreneurship (set up with co-chairs from the non-profit, business and government sectors) including proposals to enable social finance and social enterprise in the province.³
- Nova Scotia's Premier Darrell Dexter in late 2011 announced an inclusive strategy for his government to "[o]ne, improve access to capital for social enterprise; two, build support for non-profits to engage in social enterprise; and three, remove barriers to social enterprise from legislation and policies."⁴
- Ontario's Partnership Project, led by Minister Eric Hoskins and Helen Burstyn, called last March for increased investment in social innovation, specifically recommending that the province "[w]ork with the Government of Canada and Canadian financial institutions to address regulatory and legal barriers to social innovation, and make a range of social financing tools available to Ontario's not-for-profit sector."⁵
- Quebec's Minister Lessard responsible for Municipal Affairs, Regions and Land Occupancy announced government support for a federal, provincial, territorial dialogue geared toward social economy progress in Quebec at the FIESS conference in October 2011.

These efforts, focused on the sustainability of the sector, are just some of the examples signaling an important transition underway. But outdated federal rules remain a barrier.

Evolving to Financing from Fundraising – A Paradigm Shift

Charity finance, primarily debt capital for non-profits, is a subset of an emerging investment practice called social finance, or impact investing. This is a complement to, not a replacement of, traditional fundraising.

Driving this new investment class is a stark reality that the existing pool of government and philanthropic dollars is not enough to capitalize non-profit endeavours and expand sector capacity to tackle persistent social problems.

³ Specific recommendations include: amendments to the BC Business Corporations Act to introduce a Community Contribution Company (non-profit hybrid), a social innovation tax credit, a social innovation fund, a social impact bond, and an institute of social innovation measurement

⁴ Speech by Premier Darrell Dexter, November 21, 2011 at the National Conference on Social Enterprise, Halifax, Nova Scotia.

⁵ The Partnership Project, An Ontario Government Strategy to Create a Stronger Partnership with the Not-for-Profit Sector 2011 (Toronto, March 2011), p. 8

Just as we appreciate how technology changes (steam, electricity, transistor, personal computing) or regulatory changes (limited liability corporate form, housing mortgages, etc.) have historically translated into dynamic business cycles creating wealth and prosperity, so too government has the policy levers to introduce regulatory changes expanding ways charities could employ diversified revenue models, including earned income. Leaving the status quo in place squanders the opportunity to learn from the growing body of proven international and regional Canadian experience and innovatively develop new impactful ways non-profits can create value for society.

The very recent Australian Senate Economics Reference Committee study, *Investing for good: the development of a capital market for the not-for-profit sector in Australia*⁶, signaled the paradigm shift currently underway in Australia. The report recommends that government “develop a sustainable primary market for not-for-profit debt in Australia”. A specific recommendation was made to incent investment in non-profits through tax measures. Another was to emulate Canada and the UK by establishing a Social Finance Task Force.⁷

The UK government, which is facing serious fiscal challenges and implementing serious cuts, is committed to catalyzing a dynamic social finance marketplace involving private capital. Benefitting from the leadership of Sir Ronald Cohen’s Social Investment Task Force (which ran from 2001 to 2011), the UK has investment funds, innovative financial instruments, and a dynamic social enterprise sector generating significant social impact in the face of government restraint. In 2011, with the support of government and a pool of capital from unclaimed assets, Big Society Capital was created and will eventually provide £600 million of wholesale finance to charities, non-profits and social ventures. In their latest report on social investment, the UK government highlighted the emerging role of finance for charities to complement traditional sources of funds:

“We want to make it easier for social ventures to access the capital and advice they need to grow, unlocking the potential to improve more lives. So at the heart of our vision is nothing less than a new ‘third pillar’ of finance for [social enterprise], to sit alongside traditional giving and funds from the state”.⁸

The emergence of Social Enterprise and Social Finance in Canada

Social enterprises are a vital and growing part of the fabric of innovating organizations that meet community needs and provide economic benefit to Canadian citizens.

Market-sourced earned income is the largest –and fastest growing – source of charity’s income. For charities and non-profits during the period 1997 – 2007, the share of revenues received from the sale of goods and services and membership fees has increased from 57.3% to 61.5% mostly because of increases in revenues from the sale of goods and services. As earned revenues increased, the share of total revenues from provincial government transfers declined (from 17.8% in 1997 to 14% in 2007) as did the share of revenues from household transfers (from 14.2% to 12%).⁹

On the capital supply side, current social finance assets under management in Canada total \$2.7 billion¹⁰ but untapped pools of private capital on the margins of the market await investment

⁶ Economic Reference Committee (Nov 2011). *Investing for good: the development of a capital market for the not-for-profit sector in Australia*.

⁷ Australian Senate report link:

http://www.aph.gov.au/senate/committee/economics_ctte/capital_market_2011/report/index.htm

⁸ Refer to the UK Governments latest report on social investment, “Growing the Social Investment Market: A vision and strategy”, 2011. <http://www.cabinetoffice.gov.uk/resource-library/growing-social-investment-market-vision-and-strategy>

⁹ Source: Hall, Michael. 2010. “Change is in the Air: The Economic Realities of Canada’s Nonprofit Sector” *The Philanthropist* 23.

¹⁰ “Mobilizing Private Capital for Public Good,” Task Force on Social Finance, 2010.

opportunities that generate social and environmental returns. A supportive regulatory regime for social enterprise is needed for two main reasons: support and encourage investors to leverage private capital for public good, and effectively enhance the financial resiliency of the non-profit sector and reduce its dependency on donations and grants.

Current Barriers Stalling the Opportunity

In addition to general hurdles (awareness, market fragmentation, social impact standards, capital access, etc.) affecting the marketplace for social finance, specific legal and regulatory barriers are stalling growth.

Non-profits generating income

In a 2010 study of non-profits in Ontario, nearly half of the social enterprise respondents started operations in the past five years and one-third of respondents without social enterprise activity had plans to start a new venture in the next two years. However, over 50% of these organizations indicated the current legal and regulatory environment was a barrier to engaging in social enterprise activity.¹¹

The federal Income Tax Act and CRA policy for charities allows only a very narrow window for eligible earned-income. The rules are obtuse and difficult to understand. Consequently, many charities are offside with CRA with respect to how their social enterprises are structured.¹² One knowledgeable observer speaking to federal and provincial officials in 2001 estimated 75% of enterprising non-profits to be offside.

Policy change, building on new legislation in Ontario and British Columbia, like the destination of profits test, would allow non-profits to carry on enterprising activities without burdensome regulation and would act to diversify, rather than inhibit, non-profit sources of revenue.

Finance Policy Recommendations to Support the Opportunity

The way forward has been well documented in a groundswell of research conducted by numerous associations, think tanks and initiatives including Imagine Canada, the Public Policy Forum, CCEDNet, The Mowat Centre for Policy Innovation, The Tri-Ministerial Partnership Project (Ontario), and the Canadian Task Force on Social Finance.¹³

The Canadian Task Force on Social Finance was convened in 2010 to determine how best to catalyze the creation of a financial marketplace serving social enterprise. It recommended seven key actions that Canada needs to undertake, in parallel, to mobilize new sources of capital, create an enabling tax and regulatory environment, and build a pipeline of investment ready social enterprises.¹⁴ Of the seven recommendations of the Task Force, three are particularly relevant to the Committee's charity mandate.

I. Mobilizing Capital

The federal government should stimulate capital market formation by partnering with financial institutions to create national and regional impact investment funds that serve social enterprises. These funds should include a focus on debt capital for charities.

¹¹ Malhotra, A., Spence, A., & Laird, H. (2010). *Social finance census 2010*. MaRS Discovery District & Ontario Nonprofit Network: Toronto, ON.

¹² Corriveau, S. (2010). *The fine print: Vital Information for Canadian charities operating social enterprise*. BC Centre for Social Enterprise.

¹³ Recent reports include: Elizabeth Mulholland, Matthew Mendelsohn and Negin Shamshiri, "[Strengthening the Third Pillar of the Canadian Union: An Intergovernmental Agenda for Canada's Charities and Non-Profits](#)", [Mowat Centre, March 2011](#)

¹⁴ www.socialfinancetaskforce.ca

Cost Implications: \$100 M (\$20 M annually for 5 years), conditional on private sector matching

II. Modernizing Legal and Regulatory Frameworks

The Finance Department should modernize Canada Revenue Agency (CRA) regulations, which inhibit charities and non-profits from developing in-house or subsidiary social enterprises, by establishing a destination test to govern eligible earned income (i.e. any enterprising strategies are permissible as long as any surplus generated is dedicated to the charity's mission).

Cost Implications: Zero-cost legislation and there would be an expected increase in economic benefits by increasing employment for vulnerable populations and reducing strain on social services

III. Enabling Private investment via Tax Incentives

The federal government should develop targeted tax incentives to accelerate private capital investment in the social enterprise sector; a multi-sector working group involving the federal government, provincial and territorial governments, and the finance and social enterprise sectors should collaboratively develop specific proposals. This initiative is complementary to proposals for increasing charitable donations by providing enhanced tax incentives to donors.

Cost Implications: Tax expenditure to be determined based on outcomes of a proposed multi-sector tax working group involving governments (federal/provincial/territorial), the finance sector and the social enterprise sector. This working group should be established to explore the range of possible tax incentives for social enterprise.

Implementing these recommendations would ensure that:

- The social enterprise sector develops more rapidly, effectively and efficiently;
- Communities and individuals have more ways to assist in financing community organizations; and
- Private capital markets can become a major source of capital to social enterprises to complement government contributions.

A Way Forward

Government should make social finance development an integrated feature of its economic and social agenda¹⁵, recognizing that social finance will strengthen the charitable sector. Priority should be given to the tax and regulatory environment recommendations proposed above.

Specific to the recommendations, government should work with leading institutions like Cardus, Mowat, Imagine Canada, and CD Howe who have conducted relevant research and set-up cross-jurisdictional, cross-ministerial working groups to explore viable options for each of the recommended actions. Through this engagement and the subsequent positive action, government will enable local communities to be more active and successful in meeting local needs.

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¹⁵ The 2009 Standing Committee on Finance recommended: "the creation of a corporate structure for not-for-profit organizations that would allow the issuance of share capital and other securities"; In the 2011 Federal Budget, the government recognized the Task Force on Social Finance and said that it "will consider opportunities to leverage social venture financing through innovative partnerships that can demonstrate cost savings while maintaining or enhancing service levels."