21st Century Financing: Exploring New Sources of Investment for Social Transformation

Social Capital Market Roundtable #2

A Report of the Session

March 13, 2006
Simon Fraser Harbour Centre, Vancouver BC

Organized by:

PLAN ...for the future Planned Lifetime Advocacy Network (PLAN)

TIDES CANADA FOUNDATION

with **Ashoka** and **Vancity Credit Union**

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Plan Institute for Caring Citizenship & Tides Canada Foundation
With Ashoka and Vancity Credit Union

Tides Canada Foundation, the Plan Institute for Caring Citizenship, Ashoka and Vancity Credit Union hosted a roundtable dialogue on 21st Century Financing: Exploring New Sources of Investment for Social Transformation. Attended by over 30 representatives from social enterprises, non-profit organizations, governments, financial institutions, and other businesses (list of participants below), the Roundtable considered key questions such as:

1. What are the new and emerging sources of social finance?
2. How can we accelerate the development of social capital markets?
3. What public policy changes are needed to foster a social capital marketplace?

This dialogue is the second in a series of roundtable discussions on the Social Capital Marketplace. For a copy of the first one, "Over the Horizon: The Future of Canada's Capital Market for Social and Environmental Innovation", go to: http://www.tidescanada.org/files/pdf/over_horizon.pdf

Context

The following is a summary of the keynote presentation, panel and roundtable discussion.

A new wave of change-makers, social innovators and social entrepreneurs is emerging in British Columbia who know that good ideas are not enough—good ideas must be capable of going to scale, must generate big and bold impact and must be long-lasting and durable. Financing their initiatives is amongst their biggest challenges. Traditional funders—governments and foundations—focus on funding short term projects while financial institutions focus on financial returns, with the result that the momentum, critical mass and tipping point required to advance transformative social change are held in check.

These social innovators are, however, people in a hurry seeking new sources of capital. They look for social investors: financiers with patient capital who value both financial and social returns. New models of investment—i.e. social capital markets—are becoming the new architecture for social finance. Funding pools and social investment instruments are being developed to diversify risk, spread costs and scale-up returns. Tools to improve the information flow between investors and social innovators are on the horizon. In other words, the efficiency and scalability of social capital markets are finally receiving some long overdue attention.

Clearly the rapidly growing needs of the social sector for financial support cannot be met under current arrangements. In order to encourage and support social innovations that will be durable, scalable and have an impact, these must be our priorities:

1) Reforming current funding policy and practices of government, financiers and foundations; and
2) Developing new sources of capital.

"It is time to unleash the power of the market and private capital on the most pressing social issues of our time." Arthur Wood, Head of Social Financial Services for Ashoka

Introduction

Tim Draimin, Executive Director, Tides Canada Foundation, provided an overview of the roundtable session, which is a follow-up from the September 2004 Social Capital Market Roundtable. He noted that while total charitable giving in Canada totals $6 billion, this is only a small part of the total non-profit revenue and expenditure which exceeds $100 billion annually. Research shows that while giving is increasing the number of donors is actually dropping. Canadian charities currently are dependent on a very high level of government funding (over 50% of revenue). Growing demands on non-profits to spearhead social innovation, as well as provide for service provision, require creative thinking on how new social capital can be made available to the sector so that they can grow and scale up their work as well as diversify their income.

This non-profit agenda can be advanced by building opportunities to share and build knowledge on social financial capital and finding ways and means to advance collaboration in the sector. New and emerging sources of capital need to be identified and accelerated while public policy changes will be necessary to further enable social capital markets.

Keynote Presentation: From Top Down to Bottom Up: Strategies and Challenges

Arthur Wood
Head of Social Financial Services,
Ashoka, Washington, D.C.

Arthur Wood *spearheads the Business Entry initiative as part of the Social Financial Services program at Ashoka, the objective of which is to engage global financial services firms to enter the business of social investing and ultimately change the way investors view and approach social investing, as well as increasing the flow and efficiency of financing to the social sector. Prior to joining Ashoka, Arthur worked for over 20 years in the finance sector having held a number of senior positions in product development, change management, sales, and strategic marketing with companies such as Merrill Lynch and Coutts - the UK's oldest and most prestigious Private Bank.*

Ashoka*'s mission is to shape a citizen sector that is entrepreneurial, productive and globally integrated, and to develop the profession of social entrepreneurship around the world. Ashoka identifies and invests in leading social entrepreneurs—extraordinary individuals with unprecedented ideas for change in their communities—supporting them, their ideas and institutions through all phases of their careers. Ashoka has worked with 1700 social entrepreneurs in 16 countries who have a systems changing idea that is creative, entrepreneurial and sustainable. In addition to financial support Ashoka links the social entrepreneurs in networks and helps them to create the architecture to bring their ideas and the social sector to scale. www.ashoka.org*

The current system of financing needs changing and we need to change the course we are on as a society. Social trends are only getting worse; there will be an increasing strain on resources over the next 30 years with population aging, unfunded pension liabilities and pressures on the tax system. This situation is not sustainable.

The problem is not one of a lack of capital, but a problem with the system of capital allocation. Historically there have been two primary models of social financing, the state model which is inefficient in directing capital and which has vested interests in the status quo; and the market system of foundation capital in which recipients negotiate bilaterally with funders and spend inordinate amounts of time in capital raising. Studies have shown that the transaction costs for fundraising are 20 – 50% of funds raised[1].

However, there are grounds for optimism. There is a considerable growth of philanthropy around the world, and the largest ever transfer of human wealth is predicted over the coming decades. $41 trillion will be transferred through the estates of the baby-boom generation. 60% of these assets are controlled by 1% of the population. It is predicted that $2 trillion will be injected into the non-profit sector as a result of this wealth transfer. After the emerging economies of India and China, the financial sector will become interested in this asset transfer in the coming period.

A third model of social financing is emerging in this context: the use of market mechanisms to allocate social capital. This third pillar will be focused on social entrepreneurship, venture philanthropy and micro-finance.

Looked at as an investment market, it is apparent that the social finance sector is structurally inefficient. Currently investors are offered one of two options a -100% return or a + 5% return, i.e. a grant or a market investment. However, there are a range of positions on this continuum which need to be articulated.

Ashoka is promoting the concept of "Full Economic Citizenship" for civil society organizations and are engaging the corporate sector, particularly financial institutions, and policy makers on developing the tools and programs to scale up civil society organizations to meet the challenges of the century. They are focused on overcoming silos and fragmentation by collaborating with the corporate sector and policy makers to identify best practices and best player to scale up innovation and impact. They are seeing some progress with major financial institutions that are beginning to engage in micro-finance.

Some of the questions going forward are:

- How to help social entrepreneurs collaborate?
- What is the proper role of foundations in creating innovation and scale – as think tanks, banks, venture capitalists, etc?
- How do we create mechanisms for government, business, foundations, civil society organizations and other sectors to work together?
- Can the core skills of the commercial and banking sectors be levered to help advance innovation?
- How can government instruments be used to overcome the distinction between non-profit and for-profit models to unleash the market? Government tax legislation is 'siloed'; can government use their subsidies to advance hybrid models?
- What can be done to advance a sustainable and effective social sector?

[1] See William F. Meehan III et al, "Investing in Society: Why we need a more efficient social capital market – and how to get there", Stanford Social Innovation Review, Spring 2004.

Respondents

Derek Gent
Investment Manager, Vancity Capital Corporation

Vancity has been working with the blended value model to integrate social and financial perspectives into its operations and products. Socially Responsible Investment and Corporate Social Responsibility are examples of this. Vancity is experimenting with hybrid investments, which are both (or neither) loans and grants, called "groans". If clients pay the investment back it is a loan and if they don't it is deemed a grant.

Because of its co-operative roots, Vancity is interested in mobilizing community capital. Co-operatives offer a democratic mechanism to engage communities in mobilizing capital for their own purposes.

Milton Wong
Businessman, philanthropist and Chancellor of Simon Fraser University

The capital markets are underpinned by a 300-year old philosophy, which is hard to replace with sustainability thinking because the old habits are so engrained. Keynesian economics, based on a model of consumption, argues that increased consumption will get the economy moving. This view affects our approach to social policy. The education system is critical to moving the sustainability agenda forward.

Similarly with multiculturalism, we have come to learn that we are all part of the living system and we must learn to live together in harmony. When society understands the basic cultural and natural systems of our world we can better understand how to move forward. Those who recognize that financial capital derives its value from natural and human/intellectual capital start to think of the world differently and design new models and systems for moving society forward. The education process is key.

David Driscoll
Advisor to CEDTAP[2] and former Executive Director, Vancity Community Foundation

The national Social Economy initiative is helping to shape how the non-profit sector thinks about its roles and relationships in the economy. This effort is greatly strengthened in Quebec, where task forces involving labour, co-operatives, NGOs, government and the private sector are building a mixed economy.

The Social Economy initiative is focused on supporting capacity building and a knowledge base in Canada, in the form of community-university collaborations to advance the sector on the knowledge front.

Moving forward we need to identify the best role for government. Perhaps we should set up a "who does what committee". The public becomes cynical when government provides products (programs) because they are not good at it. Caring doesn't occur in large institutions – that is where you go when you want corruption. Caring happens in community.

[2] CEDTAP: Community Economic Development Technical Assistance Program based at Carleton University

Discussion

In the discussion period participants were asked to address three questions:

1) What are the new and emerging sources of social finance?
2) How can we accelerate the development of social capital markets?
3) What public policy changes are needed to foster a social capital marketplace?

New and emerging sources of social finance

The following sources of social finance were identified:

1) **Existing pools** of capital, including pension funds, union groups, credit unions, banks, foundations, high net worth individuals, investors, venture philanthropists, etc. Foundations could invest their endowments in social finance, whereby they invest for both a social and financial return.
2) **Create new pools** of capital through community investments, whereby foundations or financial intermediaries develop donation or deposit programs for social investors to invest in double bottom-line projects.
3) **Leverage existing capital**, such as using assets within non-profits as loan collateral (e.g. computers, buildings, land, etc.). There are examples where initial investor capital is leveraged to generate a larger investment pool. (e.g. GrowthWorks invested $1 M in BC Community Futures Association and they were able to lever this to $9 M from other investors). Other efforts are being explored where foundations would offer a loan guarantee to a social enterprise seeking to raise financing from traditional financial sources.
4) The Federal **New Deal for Cities** program will be transferring tax points to municipalities for use in municipal infrastructure. Can some of this funding be harnessed to support a social economy initiative? Perhaps local governments can be encouraged to develop integrated community sustainability plans that include provision for the social capital market.
5) **Communities** can be a source of capital through the credit union or community investment model.

How to accelerate the development of social capital markets

Participants identified challenges to, and opportunities for, the development of social capital markets, as follows:

Challenges and barriers to the development of social capital markets:

- Current diseconomies of scale in which civil society organizations spend considerable time bi-laterally fund-raising
- The current financial system is in silos
- Values-disconnect with the private and financial sectors. How can civil society organizations retain their values and culture once they have entered into partnerships with the private sector?
- Concerns about government off-loading to the community sector and private provision of public services. Are we abandoning collective provision of public goods if we consider financial models other than state provision?

- Need to come up with a financial model that prices risks and failure in the community sector. Who should pay for the risk: governments, the tax system, high net worth individuals? Society has to find a way to price and allocate risk.
- It is difficult to measure social impact; there are few standards for social metrics and indicators.
- It is difficult to change the status quo. Governments, for example, are reluctant to move away from central control where they see it as their role to design and deliver social programs.

Opportunities to overcome barriers to the development of social capital markets:

- Develop partnerships:
    - Bridge silos and leverage our networks; find a way to link to social capital market development to Corporate Social Responsibility (CSR) and Socially Responsible Investment (SRI) movements.
    - Co-production and collaboration with community, academics, private sector and governments in the design of social capital market instruments and policy vehicles.
    - Financial institutions can help influence the philanthropic relationship. They are motivated to participate in a partnership as they see the transfer of wealth as a strategic business opportunity.
- Support the development of new roles for foundations, private sector, governments, etc. Determine who does what and why?
- Identify and support intermediaries and aggregators. What role should intermediaries play in the future? Foundations could become the consolidators of the citizen sector in order to get aggregations and move towards scale.
- Support capacity building and knowledge development. The sector should invest in the capacity and growth of their operations. Successful businesses allocate a portion of their returns to invest in organizational capacity and management infrastructure. The non-profit sector should follow this approach. Support should be provided to encourage community-academic collaborations as well as for knowledge transfer between the social and business sectors.
- Encourage the community, collective and democratic process. Change should be driven from the bottom up. The financial sector could be engaged because they are part of community. When the community is convened different solutions are identified.
- Need to develop a strong accountability framework in which impact is measured. While it is difficult to generate perfect numbers, proximate measures which capture the holistic nature of impact, including interdependencies and quality of life, can be developed.

Public policy changes needed to foster a social capital marketplace

Participants identified the following public policy changes to advance social finance:

- Recast legislation from a for-profit/not-for-profit framework to a sustainable and effective framework.
- Offer tax incentives to encourage investments in social finance. A few well-positioned tax credits can make a big difference, as demonstrated by housing tax credits in the US market.
- Create a framework that permits organizations to build capacity through capital retention, e.g. 25% of earned revenues to be allocated to growth and management infrastructure.

- Create an enabling environment for trustees to consider community investments consistent with their fiduciary duty. Clarify that it is acceptable to maximize returns as opposed to optimize returns.
- Create a permissive framework for foundations to support social finance. For example, clarify that foundations can provide loan guarantees and other creative financial instruments to advance the social capital marketplace.
- Negotiate an allocation from the New Deal for Cities for the articulation of environmental, social, cultural and economic goals into municipal sustainability plans and checklists

Next Steps

The following thoughts were proposed as next steps, most of which were included in the evaluations submitted by participants after the dialogue:

1) Dialogues: Convene gatherings like this in major Canadian centers to identify the public policy agenda and enabling architecture
2) Pilots: Launch and profile pilot projects to demonstrate benefits of this model; build on success and share with others
3) Public policy: Develop a detailed public policy and legislative program to support the social capital market; figure out who does what through an engaged, collaborative process
4) Networks: Connect with the Community Investment Network and the BC Social Economy Roundtable
5) Partnerships: Engage the business community
6) Research: Develop a research program on the social capital marketplace; including international best practices, and dialogues outside of North America

Prepared by:
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Report #1, Over The Horizon: The Future of Canada's Capital Market for Social and Environmental Innovation is available at: www.tidescanada.org

Participants:

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Jack Styan	PLAN
Jan Taylor	BC Co-operative Association
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Acknowledgements

Thanks very much to Brian Smith who, with the help from Kristi Mader, so ably organized all the logistics and preparations for the Roundtable.

Thanks also to Coro Stranberg for her thoughtful and comprehensive summary, synthesis and reporting on the meeting.

And appreciation to Ted Jackson who, although he was prevented from participating as a respondent by travel weather delays, was present in spirit.