Social Finance: Challenges and Opportunities to Scaling the Pipeline

Companion Report: Literature Scan

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Introduction

This is a companion report to research conducted for Employment and Skills Development Canada on how to scale the social finance pipeline. It summarizes results from a literature scan on the characteristics of prospective social finance recipients and the barriers and challenges they face in accessing social finance capital.

The literature scan, conducted in March 2013, reviewed primarily Canadian publications from 2009 to 2012 which analyzed the state of social finance in Canada. Appendix A provides the full list of publications included in the scan.

Literature used for this scan comes from the most prominent researchers on this topic in Canada and also includes reports of key thought leaders from nations more advanced in the development of the social enterprise sector.

The literature scan was used to develop a foundational understanding of the topic, provide insight into the nature of the sector and characteristics of social enterprise in Canada and inform the key informant interview guide. The main report is available at this link.

Characteristics

The first Social Finance Census conducted in Ontario in 2010 surveyed 244 social ventures and non-profit organizations. The census found that non-profits' current engagement and future interest in social enterprise activity is high. Almost half (46%) of all non-profits surveyed (n=196) are engaged in social enterprise activity, and one-third of the remaining non-profits are considering engaging in such activity within two years[1]. 15% have brainstormed an idea (or ideas) for a social enterprise, 9% are actively exploring the feasibility of a specific proposal for a social enterprise, and 3% are in the process of actually starting a social enterprise[2].

Nearly three quarters (72%) of those considering or planning social enterprise activity plan to consult with other organizations for start-up advice. 64% intend to refer to the experience within their own

[1] http://www.socialventureexchange.org/docs/sfcensus2010.pdf (p. 6)

[2] Ibid. p. 23.

organization's leadership. A majority of respondents (>50%) also plan to engage with legal counsel, accountants or financial advisors, and other business people unrelated to the organization[3].

Primary funding sources of non-profits include government, foundations, donors and corporate sponsorships. Bank loans, lines of credit, and mortgage on fixed assets are rarely used by the sector[4]. However, there is great potential for alternative sources of capital: nearly half of the non-profits (48% of those with social enterprise and 49%of those without) would be willing to take on debt in the form of loans or bonds.[5]

Over 60% of all non-profits are interested in learning about additional social and/or environmental measurement tools in order to effectively measure the impact of their work[6].

Dr. Tessa Hebb, of the Carleton Centre for Community Innovation, conducted a study on "The Utilization of Social Finance Instruments by the Not-For-Profit Sector" over 2011-12. Interviews with 41 representatives from non-profits and charities, along with social enterprises and social finance intermediaries in Canada, revealed that only a few of the non-profits and charities had used credit (i.e. loans or credit lines) and none have used external equity as a source of finance. (Five charities had used loans and credit lines ranging from $40K in working capital to $14M for mortgage finance[7].) This contrasted, not surprisingly, with the social enterprises in her study which frequently used social finance instruments including market-based earned income, loans and lines of credit.

While the non-profits and registered charities expected grants and donations to support future growth, social enterprises predicted future growth to come through market-based activities[8]. Additionally, most non-profits and charities expressed discomfort with the idea of a loan, with several suggesting that their boards of directors would not want to take on such a risk[9]. Note that this contrasts with the nearly 50% of the Ontario Social Finance Census non-profit respondents which were open to debt financing.

There were notable references to community partners (not defined) in the Hebb study:

- All six non-profits mentioned their engagement with community partners as a key in their revenue generating strategies[10];
- Social finance intermediaries worked with community partners in helping non-profits become loan-ready[11].

This suggests that community partners might play a beneficial role in supporting non-profits and charities in becoming investment-ready. They can provide support, advice, access to markets, and potentially reduce investor risk through their third party credibility.

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[3] Ibid.
[4] Ibid. p. 18.
[5] Ibid. p. 7.
[6] Ibid.
[7] http://www6.carleton.ca/3ci/ccms/wp-content/ccms-files/3ci-Utilizing-Social-Finance-Report-August-16-Final.pdf (p. 18)
[8] Ibid. p.1-2.
[9] Ibid. p. 25.
[10] Ibid. p. 15.
[11] Ibid. p. 23.

Finally, the Hebb study found that very few of the non-profits and charities have hard assets such as real estate[12]. This contrasted with the earlier study which reported that, in terms of their capital strength, one in three non-profits have fixed/long-term assets of over $500,000[13].

A UK briefing paper[14] on access to capital for the charitable sector commented that there are a variety of reasons behind the sectors' preference for grants, beyond familiarity, including:

- The lack of recognition of a distinction between different types of money – the basic income/capital distinction, the various forms of capital need, and how these are best met (using different financial mechanisms);
- The perception that grants and donations are 'free money', although such money is rarely free. In the UK most charities find it costs between 15 and 25p to raise £1.14. Further, the costs of reporting on the grant can be high: the average cost of the reporting burden (over and above what the charity would spend on its own reporting) has been assessed at about 6% of the original grant;
- A sense of entitlement, along the lines that charities do good work and should therefore be given the money;
- Skepticism regarding the motives of suppliers of alternative forms of finance. Why do specialist banks and lenders, and those who invest in such institutions, do so? Are they really interested in supporting charities in their mission, or are they interested in getting their money back, or indeed are they getting involved because they are aiming to make money?

The foregoing research and commentary reveals the following insights into the characteristics of the non-profits and charities considering or engaging in early stage social enterprise activity:

- Current engagement and future interest in social enterprise activity is high;
- Some openness to financing models beyond traditional donations, grants, corporate sponsorships and government contracts;
- Organizations have limited to no experience with debt and equity financing
  - Risk averse
  - Limited financial literacy
  - Grant orientation
- Some organizations have a strong capital asset base which can be leveraged for financing;
- Organizations plan to engage internal leaders and consult other non-profits/charities, and professionals such as legal counsel, accountants, financial advisors and business people; and
- Community partners can play an enabling role by providing support, access to markets, etc.

The next section reviews the barriers faced by non-profits and charities as they prepare to engage in social enterprise activity.

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[12] http://www6.carleton.ca/3ci/ccms/wp-content/ccms-files/3ci-Utilizing-Social-Finance-Report-August-16-Final.pdf (p. 25)
[13] http://www.socialventureexchange.org/docs/sfcensus2010.pdf (p. 5)
[14] http://www.marmanie.com/cms/upload/file/CAF_Venturesome_Access_to_Capital_0909.pdf (p. 4)

Barriers

The most common type of challenge or barrier cited in the literature is the need for early stage business support and assistance. Non-profits and charities confront many of the same challenges faced by traditional business start-ups: limited business experience, limited technical infrastructure and a need for an effective business plan and a strong management team. They lack financial literacy and access to information, business guidance, and technical consulting services. For over 45% of non-profits surveyed in the Ontario Social Finance Census, lack of business development support for social enterprises is a very important barrier to social enterprise activity[15]. Similarly, the study found, resources to access business development support and capacity building support are high priorities for over 60%of all non-profits, both with and without social enterprise.

The Social Finance Task Force provided an overview of current federal and provincial/territorial government assistance offered to support the growth and development of small business, including[16]:

1. Counseling and information services;
2. Business skills training;
3. Business plan guidance;
4. Revenue model development;
5. Mentoring;
6. Market analysis and development and other consulting services;
7. Technology development;
8. Talent management;
9. Financing support; and
10. Governance.

Presumably, non-profits and charities pursing social enterprise activities would need a similar mix of business support and technical assistance, although such assistance may need to be customized. The majority of the non-profits in the Ontario Social Finance Census which did not have existing social enterprise activity, prioritized "access to advice/support for organization growth/capacity building (70%); tools and advice to measure social and environmental impact (65%); and access to advice and support for business plan development (60%)[17].

The Hebb study found that financial skills and knowledge at both the board and management levels is a key credit-readiness factor[18]. The social finance intermediaries in her study indicated that strong financial governance and management is one of the investment readiness criteria.

Many of the non-profits in the Ontario Social Finance Study indicated that lawyers and accountants require greater literacy in the social venture field[19].

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15 http://www.socialventureexchange.org/docs/sfcensus2010.pdf (p. 7)
16 http://socialfinance.ca/uploads/documents/FinalReport_MobilizingPrivateCapitalforPublicGood_30Nov10.pdf (p. 27)
17 http://www.socialventureexchange.org/docs/sfcensus2010.pdf (p. 30)
18 http://www6.carleton.ca/3ci/ccms/wp-content/ccms-files/3ci-Utilizing-Social-Finance-Report-August-16-Final.pdf (p. 2)
19 http://www.socialventureexchange.org/docs/sfcensus2010.pdf (p.5)

A study of social enterprise access to small business services conducted by Enterprising Non-Profits in 2011 included a survey of government officials, social enterprise leaders, developers and advocates and active social enterprises. The following excerpts reveal additional areas where specialized capacity building may be required (SE refers to social enterprise):

- Starting up a SE is much more work, due to different decision-making structure and limited governance and management experience;
- 80% is the same (marketing is marketing, etc.), but how to account for social impact and governance is totally different;
- It is important for SEs to use the right language and build a business case; and
- The supports need to be accessible and located in the community, and there needs to be business developers as opposed to just lenders[20].

According to the Social Finance Task Force, "social enterprises rely heavily on a small number of regional organizations focused on delivering business and financing supports tailored to their needs. These services are in high demand but short supply, and cannot meet the growing need for early stage business supports and services similar to those provided to traditional small businesses"[21].

Internal barriers

The Social Finance Census 2010 referred to earlier documented[22] the internal barriers for those who responded positively that they were considering/engaging in social enterprise activity within the next two years as follows:

- Lack of available internal funds (76%);
- Lack of internal resources including staff members, computers and facilities (66%);
- Lack of internal expertise or leadership (44%);
- Fear that engaging in social enterprise activity will take the organization away from its core mission (38%);
- Challenge in validating market demand for proposed social enterprise (36%);
- Culture of risk aversion amongst organization's decision-makers (34%).

External barriers

Similarly, the same study identified[23] their external barriers to pursuing social enterprise activity (not including regulatory or capital access barriers) as:

- Access to business development support (e.g. business planning, research, marketing) (51%);
- Investor/funder buy-in on the viability of engaging in social enterprise (37%);

[20] http://tinyurl.com/c7t6guj
[21] http://socialfinance.ca/uploads/documents/FinalReport_MobilizingPrivateCapitalforPublicGood_30Nov10.pdf (p. 28)
[22] http://www.socialventureexchange.org/docs/sfcensus2010.pdf (p. 25)
[23] http://www.socialventureexchange.org/docs/sfcensus2010.pdf (p. 26)

- Lack of awareness on the part of lawyers and accountants (26%); and
- Lack of access to legal and/or financial advice (26%).

The aforementioned UK paper[24] comments that a robust social finance market needs a non-profit and charitable sector that is:

- Confident in identifying its own financial needs;
- Aware of different mechanisms (grants/loans/equity) available to support those needs, and the associated risks;
- Aware of different providers (from income to capital suppliers), and their motivations;
- Confident in seeking appropriate capital from a variety of sources.

For this, the authors argue, the sector needs stronger finance functions (i.e. financially confident CEOs and boards), and a greater pool of chief operating officers, finance directors and treasurers attracted to the sector.

[24] http://www.marmanie.com/cms/upload/file/CAF_Venturesome_Access_to_Capital_0909.pdf (p. 4)

Appendix A

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Social Enterprise Access to SME Services, David LePage (Enterprising Non-Profits) March 2011

http://tinyurl.com/c7t6guj

Access to Capital, Charities Aid Foundation and Venturesome, 2009

http://www.marmanie.com/cms/upload/file/CAF_Venturesome_Access_to_Capital_0909.pdf

Grey Literature

The following three online resources may be useful in the development of a readiness checklist:

Doing Well by Doing Good – How to Launch a Successful Social Purpose Enterprise, 2008, Toronto Enterprise Fund

MaRS Business Plans for SEs and SPBs
http://www.marsdd.com/articles/business-plans-for-ses-and-spbs/

The Social Enterprise Development Path
http://www.enterprisingnonprofits.ca/planning-your-social-enterprise