

Promoting Social Investment in Canadian Social Enterprises: Successes and Challenges

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Introduction

In 2009, as an initial foray into blended-value investment analysis, Charity Intelligence Canada (Ci) researched Canadian social enterprises. The research was well-received by Canadian donors and print and radio media, and raised \$96,962 for Canadian social enterprises. In that respect, the modest results were a success. However, the project was faced with a number of challenges, including inconsistent definitions of social enterprise, rigid tax policy, and resource limitations, and clear blended-value investing opportunities were not discovered. This paper reviews Ci's 2009 analysis of Canadian social enterprises, focusing on successes and challenges, and briefly looks ahead to the 2010 analysis.

About Charity Intelligence Canada

Charity Intelligence Canada is a newly registered Canadian charity that researches and analyzes Canada's charities to enable funders to make informed and effective giving decisions that reward charities for their results. Just as a financial analyst researches potential stocks to find the best opportunities to invest in, Charity Intelligence replicates similar research methods to find exceptional charities donors can donate to. As a result, donors have the option to give better and get higher returns on their donations, helping more Canadians in need and creating positive social change through their charitable giving. Charity Intelligence achieves this through two principle activities. First, Ci's research department analyzes Canadian charities to identify high-impact giving opportunities. These Recommended Charities are published in Ci's annual "Red Book", which is freely available online and is widely distributed to media. Last year, Ci received print and broadcast coverage in the *Globe and Mail*, *National Post*, *Toronto Star*, and CBC radio. In addition to the publication of Recommended Charities, Ci's Donor Services department works with individuals, private foundations, and corporations to develop customized high-impact giving strategies.

History and Recent Trends

Charity Intelligence is new, small, and growing quickly. Ci was founded in 2006 and became a registered charity in 2008. In the last year, donated funds to Recommended Charities increased from \$50,000 to \$330,000, including \$15,034 from online donations. At the same time, the number of clients Ci serves has more than doubled, as have unique website hits. This was achieved through only a 40% increase in operating costs.

Ci Key Metrics Ending March 31st

	2009	2010
Donations to Recommended Charities	\$50,896	\$332,185
Clients	39	92
Charities analyzed – cumulative	122	213
Unique website hits – trailing 12 months	9,890	22,554
Ci operating costs (\$) – trailing 12 months	\$129,085	\$179,493

Charity Analysis

Charity Intelligence analyzes charities intensively during a four-month period from May to August, relying heavily on paid summer interns and volunteer analysts with investment, social policy, and sociology expertise. Ci's process has been to first identify a sector of interest to donors or in need of donor attention (studied sectors include education, homelessness, and hospice palliative care). Each sector is researched in depth to identify key bottlenecks in service delivery, promising strategies, validated best practices, and results. Next, Ci generates a list of organizations of interest in the sector using list serves, databases, and referrals from donors and front-line professionals. In 2009, this list included 435 Canadian organizations. Ci interns then contact each organization, inviting each to submit financial and program information for analysis. In 2009, each organization was contacted three times, first by e-mail and then by telephone. Ci conducted in-depth analyses on the 97 organizations that submitted complete information; of these, 32 were recommended.

Ci sifts charities through a four-step process of ever-tightening screens, looking for those charities that offer the highest-impact giving opportunities.

1. Transparency and Accountability

Ci undertakes due diligence by reviewing each charity's regulatory filings. The charity's financial position is evaluated to determine whether it needs funding and its administrative and fundraising costs are calculated using consistent methods.

2009 Workflow for Recommended Charities	
435	charities on initial list
97	charities submitted complete materials
97	in-depth analyses performed
32	charities recommended for 2009

2. Program Evaluation

Analysts review each charity's programs, what it seeks to change, the evidence-based need for this change in Canada, how the charity works with Canadians in need, and the impact its work has. Charity Intelligence pays particular attention to the organization's theory of change, as well as the number and nature of clients served and the organization's on-going relationship with them, such as alumni who have been hired, regular correspondence with past participants, and, when appropriate, length of tenure with the program. Ci also looks for evidence of the organization's focus—asking about opportunities that were not undertaken because they were off-mission and seeking evidence that the charity takes reasonable efforts to track its results.

3. Benchmarking

We compare each charity with other charities providing a similar service or working with similar clients, looking for charities that offer the best results and, where results and clients are similar, at the lowest cost. These charities make the best use of scarce philanthropic resources and deserve to be highlighted.

4. The Recommendation Committee

The recommendation committee consists of five volunteers who hold or are retired from senior positions in the financial and charitable sectors. The members of the recommendation committee value the work that charities do in Canada, have experience working with and for charities, and understand the challenges charities face. The committee reviews all the charities identified by Ci's research department. As funders, they use their experience to select those charities that need only funding to be able to help more clients and offer the greatest potential impact. Their top picks become Ci's Recommended Charities.

Social Enterprise

Charity Intelligence's analysis of Canadian social enterprises was its first foray into blended-value, or double-bottom line investing. Ci strives to offer its clients a spectrum of blended-value investments. To this end, Ci set out to identify, for Canadian donors, opportunities to finance market-oriented approaches for sustainable social impact. Specifically of interest were organizations with earned revenue, a track record of social results, and promising prospects for ongoing social impact serving Canadians in need.

Identifying Social Enterprises

In 2009, analysts began by compiling a list of social enterprises. For each province, organizations and academics affiliated with social enterprise were contacted for names of social enterprises in their area. The initial list included 1,161 organizations that fit a diversity of definitions of social enterprise. Because of its own mission, Ci sought particular characteristics; the list of target social enterprises was reduced by applying the following criteria:

- a) **Ci's mission is to identify charities serving *Canadians in need*.** From the 1,161 organizations, 174 environmental-focused social enterprises; 27 fair trade organizations; and 65 culture, heritage, and recreation organizations were eliminated, along with 77 consulting, marketing, and financing organizations. Some lists were based on the broader term Social Economy Enterprise and included organizations that were social in their governance structure, but not in their client, product, or business activities; these, too, were removed.
- b) **Ci focuses on identifying high-impact giving opportunities.** Profitable businesses that donate their money to charity but do not themselves generate social impact were screened from the list and removed. This was done because Ci donors can have greater impact by giving directly to the social enterprise's recipient charity.
- c) **Ci views social enterprise as a strategy, not a sector.** Supporting Canadians in their need for food security, employment, and good mental health can be done in a number of ways, and social enterprise is among them. In order to analyze the social enterprises effectively, good background and benchmark data on the sector was necessary. Thus, the list was filtered for organizations working in one of Ci's priority sectors—education, homelessness, and hospice palliative care.

Once the filters had been applied, there remained a total of 91 social enterprises run by 87 organizations. (Three nonprofits ran more than one social enterprise.)

Contacting and Following Up

Each of the 91 social enterprises was contacted by phone for participation. Of the 91 contacted, 27 social enterprises submitted audited financial statements. The organizations that participated understood Ci's mission, were interested (sometimes excited), and submitted materials promptly. Most organizations did not submit. The main reasons stated for non-participation were that the business had closed or was not operational, the organization did not want further funding (this was particularly true for profitable enterprises that had received seed funding from a social investor), the organization was too small and did not have time, audited financial statements were not available, or, in two cases, management was adverse to the idea of being analyzed.

What Charity Intelligence Looks For in a Recommended Social Enterprise

Transparency and Accountability – A social enterprise must be willing to disclose its financial results and social results in order for Ci to examine it. This requirement eliminated 70% of the social enterprises Ci contacted to participate in the research.

Compelling Business Model – The vast majority of new businesses fail within their first five years. The added complexity of a social mission can make success for social enterprises even more difficult. From what Ci has seen in Canada, a simple, highly-focused business model in a well-researched niche is a key to success.

Gross Profit Margin – This must be positive: revenue from the sale of goods and services must exceed cost of goods sold. Otherwise, donors are subsidizing not only the social aspect of the enterprise, but also the commercial aspect.

Demonstrated Social Impact – The enterprise must have a demonstrated social impact for Canadians in need. For work-integration social enterprises, as most of those serving the homeless population are, Ci looks for evidence of job retention, job progression, or clear next steps to help employees enter the mainstream job market—evidence that employees have attained the potential to maintain a living wage.

Social Leverage – One key metric that Ci examined is the social leverage provided by the enterprise. In a traditional charity, a \$100 donation becomes \$100 in revenue that can be used to create social value. In a social enterprise, a \$100 donation might leverage \$110, \$200, or in some cases as much as \$600 in revenues by using the organization's commercial enterprise to transform the donation into higher value. The

metric we have used is Funding : Earned, a ratio of revenue donated to revenue earned, showing how much leverage one dollar donated created due to the business operation of the enterprise.

Recommendations

Only four social enterprises were recommended. However, it would be incorrect to think that those enterprises that Ci did not recommend are in some way bad or poor. Rather, to build investor credibility in a new sector, Ci's executive decision was to set a very high investment grade for recommending a social enterprise.

The most common reason for not recommending one of the analyzed social enterprises was the enterprise's theory of change. The recommended social enterprises all employed people from disadvantaged groups and had carefully thought through their employees' career paths. For example, Gateway Linens offered guaranteed employment with a private sector partner and Inner City Renovation provided advancement opportunities within the organization. By comparison, a number of social enterprises offered low-skill job opportunities with little growth, and when asked why, responses focused on factors pertinent to the organization instead of explaining why that job was appropriate and best benefitted the target population. For example, choosing to open a café because the organization has an under-used kitchen may make sense from the organization's sustainability perspective, but unless there is a strong argument for why café experience benefits the target population, the social enterprise is not a "best of the best," high-impact giving opportunity, due to a lack of client focus.

The second most common reason for not recommending a social enterprise was management. All of the social enterprises recommended by Ci had stable management or clear succession plans. Some that were analyzed appeared to have revolving door management. In other cases, while Ci did not place heavy emphasis on the social enterprise being profitable, Ci did look for a clearly articulated strategy from management on the balance between earned income and donor subsidy. Inner City Renovations, for example, was able to give a very clear articulation of where and why ongoing subsidy was needed. Others seemed to be shifting the target population to more menial jobs in order to attain profitability. To be clear, it was the lack of client focus that concerned Ci's analysts rather than the decision to hire some experienced staff. In fact, every social enterprise Ci recommended did use some experienced professionals as part of a well-articulated, compelling strategy.

Lastly, inconsistencies between a social enterprise's financial records and the parent nonprofit's financial statements prevented one social enterprise from ranking among the best found.

Challenges

The project was faced with a number of challenges, including inconsistent definitions of social enterprise, rigid tax policy, and resource limitations. Within prevailing Canadian definitions of social enterprise, there is a selection bias against for-profit organizations.

“I’m going to throw \$5,000 at Kate because I’d like to access the work she’s doing. Because I believe in it”
Brett Wilson

Most lists that Ci obtained focused on a definition of social enterprise that limited organizations to nonprofit or cooperative. For-profit firms were rare. Ci’s methodology also introduced a bias against small firms, as Ci required organizations to submit audited financial statements. Of the privately held for-profit social enterprises that were on the list, most did not have audited financial statements.

Social enterprises were visibly constrained by tax policy on the revenue of nonprofits. Tax policy also limits incentives to social investors, polarizing them between donation (resulting in a 100% financial loss) and market return, when the real spectrum could be much more exciting.

A number of social enterprises did not need funding. Theoretically, the concept of social enterprise is a conundrum for a group that provides social investment advice for the strongest—those showing strong profits and high impact are less likely to need capital. For example, Ci recommended TurnAround Couriers, which requested serviceable clients rather than funding. Ci chose to recommend TurnAround Couriers even though it did not need a donation, loan, or equity investment, because it was a strong mission-centric, integrated social enterprise.

In 2009 Ci used a grounded-theory approach, which resulted in identifying the characteristics that distinguished great from good social enterprises. Management interviews held early on in the process posed different questions from those held toward the end of the process. Ci looks forward to a more consistent analytical cycle in 2010.

Successes

Recommendation of Social Enterprises in Canada – Ci’s aim to identify, for Canadian donors, opportunities to finance market-oriented approaches for sustainable social impact held true. Ci concluded the study by identifying four optimal social enterprise recommendations for Canadian donors.

Client Response – Clients responded to Ci’s social enterprise report with very positive feedback and interest. Donations were received from 17 people for a total of \$96,962 to the recommended social enterprises. Donations ranged from \$92,000 to \$20, fulfilling Ci’s vision to take social investing to new donors. The Ci platform enables donors with smaller sized donations to participate in social investing, not just sophisticated philanthropists.

Media Coverage – Last year, Charity Intelligence launched a media initiative to share its findings with Canadian donors. This resulted in articles in *The Globe and Mail*, *The National Post*, and *Toronto Star*; a TV interview on CBC’s *The National*; and radio interviews across Canada. In addition, Ci’s website saw a dramatic increase in traffic.

Plans for Social Enterprises in 2010

This year, Charity Intelligence will continue to review social enterprises in Canada and is extending its research to **community investing**, including microcredit initiatives and nonprofit loan funds. A key challenge is identifying funds that the public can participate in, as many are essentially private placements. Ci is experimenting with a new process through which submissions are gathered. Instead of generating a list of organizations of interest, a notice inviting organizations to submit was circulated. This strategy was employed in order to cast a wider net and reduce built-in bias. Also for 2010, Ci will improve documentation so that information about what it has done, and why, is more readily available on Ci’s website and forums, such as socialfinance.ca