65 ST. CLAIR AVENUE EAST, SUITE 700 | TORONTO ON M4T 2Y3
T: 416.597.2293 F: 416.597.2294 | 1.800.263.1178

65, AVENUE ST. CLAIR EST, BUREAU 700 | TORONTO (ON) M4T 2Y3
TÉL. 416.597.2293 FAX. 416.597.2294 | 1.800.263.1178

Submission to the Social Innovation and Social Finance Steering Group

Employment and Social Development Canada

November 2017

Background

Imagine Canada is writing to ensure that the unique experiences of charities and nonprofits are integrated into Steering Group's thinking as it develops its strategy. Most social enterprises are charities and nonprofits, and organizations that by law exist to deliver public benefit must be given primacy in an eventual Social Finance and Innovation Strategy.

This discussion is framed by a widespread acknowledgement of the pressure for charities and nonprofits to continually do more with less, as donations and revenues from governments (whether in the form of grants and contributions, or as fees for delivering services on behalf of governments) cannot be counted on to grow at historic rates. Imagine Canada research demonstrates that rising economic inequality and other social and environmental pressures are important factors explaining the rapid forecasted growth in the demand for charities' and nonprofits' services. At the same time, the operating environment for organizations is increasingly constrained by long-term and continuing government divestment, an aging population, and a shrinking and ageing donor base. Earned income is the part of the funding pie with the potential to grow significantly to support organizations in meeting demands, and through which organizations may be able to better control their own destinies.

Social innovation and social finance are part of a growing trend towards smart growth; that is, growth that is inclusive, equitable, and environmentally sustainable. There is an increasing emphasis globally on using public investment to achieve multiple policy goals. Charities and nonprofits are all about smart growth -- in the way they go about their business, in the services and supports they provide, and in their capacity to create employment and economic opportunities across regions and social strata. The sector has infrastructure in place that can be tapped into by governments to further a smart growth agenda.

Charities and nonprofits have been doing social finance and social innovation for many years, but as the social finance market matures, charities and nonprofits require support to participate to their full potential. In order for the federal government to realize its goals in the implementation of a successful social finance and innovation strategy, attention must be paid to the outdated financial, legal and regulatory regimes in which our organizations currently operate.

We recommend that the unique needs and experiences of charities and nonprofits be considered as central to the eventual Social Finance and Innovation Strategy.

Capacity supports and strengthening of market infrastructure

The Issue: Research into the experience of charities and nonprofits with social finance in Canada has shown us that the demand side of the social finance market is lagging behind supply. Charities and nonprofits require access to alternative forms of finance that include flexible and patient capital, community bonds, and varying forms of loan guarantees. These forms of capital increasingly do exist and we support initiatives that make them more available; however, charities and nonprofits often cannot access them. Significant barriers are experienced by sector organizations at multiple stages, from market entry to return on investment:

- Knowledge of the social finance market, available tools & instruments, key definitions for market language, and its supports and players is generally low, particularly among smaller charities and nonprofits. This inhibits market access and navigation.
- There are significant limitations in market infrastructure. The support currently provided to charity and nonprofit social enterprises is fragmented and costly. Intermediaries that provide appropriate levels of coaching are rare in Canada, and are often not promoted or made accessible.
- There are financial literacy constraints among organizational staff who may not have the resources to engage proper supports. Social investment requires a shift in culture from gifts to loans; liable trustees feel averse to this change in responsibility (particularly because they are volunteers), or may not feel sufficiently qualified or prepared to service loans. The organization may not have resources to feel confident in the development of its investment policy; and board members are often not familiar with it.
- There are wide variations in the ability of organizations across sub-sectors to absorb capital, and to conduct investor-standard valuation of their investment product or program.
- Research shows there is a lack of accessible and standardized metrics for evaluating social investment projects. It should be noted that charitable/nonprofit social enterprises are particularly challenged when it comes to communicating social return on investment – it is expensive to evaluate, it is difficult to gain consensus on definitions of social impact, and resources are often too strapped operating double or triple bottom lines to do effective monitoring.

Our research indicates that the priority for the sector is to improve intermediary supports for the reasons identified above. Intermediaries can help with most if not all of these issues, beginning with market promotion, navigation and access. However, on the occasions when intermediaries work with social enterprises, they tend to do so for a minimal amount of time to get the social enterprise loan-ready. Many intermediaries do not even work with organizations to this extent, and focus solely on approving or denying funding applications. As a result, applications for funding are turned down at a very high rate (i.e. 4 times out of 5).

There is a need for investment of public funds in the social finance market in order to stimulate its growth and development of supports, to increase accessibility, and to attract and connect more flexible forms of investment to demand. Imagine Canada supports the development of a government-backed social finance fund, if certain conditions are met so that charitable and nonprofit social enterprises stand to benefit on equal footing with other potential beneficiaries. We believe that it is fundamental that decisions are made by community groups who are best placed to define local problems and determine solutions. Effort should be taken to avoid some of the pitfalls of similar models in comparative jurisdictions, which have led to charitable and nonprofit organizations relying increasingly on private sector partners to access funds.

An eventual fund should:

- Incorporate mechanisms and supports to ensure a strong, accountable and transparent partnership with the charitable and nonprofit social enterprise sector;
- Incorporate, through its design and administration, channels for community/practitioner input within its governing structures;
- Engage staff who are well-versed in the *evolving* needs of charities and nonprofits and ensure the ability of community organizations to access capital;
- Intermediaries are supported and seen as credible by the communities in which they operate - local needs are considered and investment streams are linked to existing sectors;
- Since this fund will deliver benefits to intermediaries by attracting and derisking investment, as well as lowering administrative/transaction costs, there needs to be a requirement that benefits experienced by the intermediaries are shared with charitable or nonprofit social enterprises. This should take the form of working more to educate & support social enterprises; requiring lower than market rates of return, and in providing assistance with evaluation.

Available capital exists for charities and nonprofits in the social finance market, though an increase in the flexibility and diversity of forms would be useful. We have listened to the calls by a number of funds and social enterprises in Canada for government support in the provision of guarantees, first loan loss, low-interest investments, and patient capital. However, while catalyzing supply of capital is good for the market, it will only go so far if demand is not empowered to take it up.

If public investment is going to be used to encourage public benefit, it is incumbent that we identify and address any such capacity issues for organizations legally tasked with public benefit objectives.

We recommend that supports for charitable and nonprofit social enterprises in overcoming demand-side market barriers be central to the mandate of new finance mechanisms (including business advisory programming within ISED; access to government-backed social finance funds). This entails a commitment of funds towards this purpose, and the strengthening of an enabling market infrastructure, including the development of accessible and supportive regional intermediaries that are accountable to local communities.

A review of the legal and regulatory framework that governs charities and nonprofits

The Issue: Registered charities and nonprofit corporations that are not registered charities face regulatory issues that may limit their ability to participate fully in innovative social finance and social enterprise initiatives.

In the case of registered charities, regulation is based largely on 19th century interpretations of 17th century statutes. Charities are operating in a 21st century environment, tackling issues and facing increasingly complex social, economic, and structural challenges and opportunities not foreseen 400 years ago. The problems with this antiquated regulatory structure are coming increasingly to the fore, and there is a risk that regulatory barriers may limit the ability of charities -- which, by their nature deliver public good -- to be full partners in achieving the federal government's objectives.

While regulatory challenges impact charities in a number of different ways, several are pertinent to this particular discussion:

- Canada Revenue Agency interpretations of "related" versus "unrelated" business activities affect the types of partnerships and entrepreneurial activities charities may undertake. Charities are already running up against regulatory barriers preventing them from engaging in certain mission-furthering activities and furthering their charitable purpose. There is increasing scrutiny of business activities that charities have been engaged in for decades, and a concern that new types of activity may be deemed "offside."
- Rules and guidance concerning investment activity by charities -- particularly foundations -- limit their ability to partner with each other and support innovative practices and business models.
- Rules on "direction and control" also limit the ability of charities to become silent partners or provide seed investments to each other.

In the case of nonprofits that are not registered charities, legislation and regulation do not allow for the existence of profitable business lines that are used to support the overall work and mission of an organization. The CRA has been increasingly vigilant about enforcing these rules. Once again, this prevents these nonprofits from providing investment capital to each other -- or to registered charities -- in order to generate a return to support their mission.

A number of the mandate letters issued by the Prime Minister to members of cabinet touch on legal and regulatory issues faced by charities and nonprofits. The mandate letter to the Minister of Justice called on her to work towards a new legal and regulatory framework for the charitable and nonprofit sector. Given the federal government's stated intent to act on legal and regulatory issues, and the negative impact that out-of-date regulations will likely have on the government's ability to meet its social innovation aspirations, the time is ripe for a modernized framework.

We recommend that the Steering Group call on the federal government to launch a comprehensive process towards legal and regulatory modernization for the charitable and nonprofit sector. Such a process would identify and address impediments towards

charities and nonprofits fulfilling their role in achieving the government's social innovation agenda.

Data about the charitable nonprofit sector

The Issue: Effective public policy making requires good data. As noted earlier, most social enterprises are charities and nonprofits, and many current charities and nonprofits will develop social enterprises or engage in social innovation and social finance in the future. In order to understand the Canadian social enterprise landscape and how best to support social innovation and social finance, we need to first understand the charitable and nonprofit sector.

The government currently lacks both key and basic data on charities and nonprofits. It has been 14 years since the last systematic census of the charitable and nonprofit sector was conducted. This means we cannot claim to have accurate knowledge of how many charities and nonprofits exist in Canada, the makeup and character of the sector, or the services they provide. The last study of the contribution of the nonprofit sector to Canada's economy was done in 2009. To put that into context, we have no understanding of the impact of the financial crisis on our country's charitable and nonprofit sector.

In order to understand how future federal policy making will impact the social enterprise sector or the ability of organizations to innovate and use social finance, government needs to prioritize the collection of data on charities and nonprofits.

We recommend that the Steering Group calls on the Minister of Industry, Science and Economic Development and the Chief Statistician to make economic data about charities and nonprofits a core activity for Statistics Canada. This would be fundamental to understanding social enterprises and social innovation, due to the fact that most social enterprises are charities and nonprofits.

Grants and contributions reform

The Issue: Past statements made by Cabinet members on the official record indicate that the government has intentionally pursued a policy of divestment from core to project-based funding. (To our knowledge, the current federal government has not announced a change to this policy direction.) Beyond the issue of core funding, grants and contributions are by and large administered in a way that not only discourages innovation, but that is harmful to organizational sustainability:

- Most grant and contribution programs exclude legitimate operational costs, such as facility costs, information technology, and financial management costs.
- Most G&C agreements do not fund evaluation efforts. This appears to be extremely at odds with both innovation and evidence-based decision-making, since by doing

so, the government could be collecting key information related to the services they contract out to organizations.

- Cash flow is problematic, with federal contributions often not flowing until a project is well under way or even complete, requiring the organization to identify and front the necessary resources.

The effects of this on our sector over the last decade in particular cannot be understated, and take the form of:

- Reduced capacity to engage in social research and development, testing, experimentation, and scale-up of new approaches to better fulfill their missions (i.e. to innovate);
- A constrained ability to retain and nurture a secure and skilled workforce;
- Less ability to engage in multi-year planning and prioritization.

The combination of these results in a situation where charities, nonprofits, and their donors are often subsidizing the delivery of government priorities. By contrast, longer-term funding will better enable charities to employ innovative strategies in service delivery, and funding for evaluation of these programs will increase the value of, and return on, government investment.

All of these difficulties with grant and contribution programs were identified and studied at length by the Independent Blue Ribbon Panel on Grant and Contribution Programs. The Panel made a series of recommendations in its December 2006 report; we are still awaiting a government-wide response to these recommendations.

We recommend that the Steering Group call on the federal government, particularly the Treasury Board Secretariat, to ensure consistent adoption of the recommendations made by the Blue Ribbon Panel across federal departments and agencies.

Social procurement

The issue: As part of a social innovation and finance legislation framework supportive of the advancement of social and environmental objectives, the government should seek to implement a procurement process that considers corporate structure and organizational mission as part of the weighting criteria.

In many cases, the procurement process at the federal level is too arduous for the average social enterprise to successfully engage, and the projects too large for capital absorption for charitable and nonprofit social enterprises to compete with the private sector. We would like to see charitable and nonprofit social enterprises linked in the development of a social value supply chain, whereby vendors are incentivized to partner with social enterprises.

We recommend that the Steering Group call on the Minister of Public Services and Procurement to work with charities to develop a comprehensive social procurement policy framework.