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Social Enterprise: oxymoronic concept or the next big thing?

Stanley Hartt examines the concept of social finance and, more specifically, "social enterprise", a relatively recent phenomenon that sees entities use the methods and disciplines of business and the power of the marketplace to advance their social, environmental and human justice agendas. Hartt notes that the UK has been refining its policies affecting such enterprises for a decade and suggests that "if we are to catch up to the lead of the UK, or be more welcoming to new concepts like the Australians, some fundamental changes to our thinking, and resulting amendments to our legislation, regulations and tax-assessing guidelines will be required."

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Sir Ronald Cohen is a dapper Englishman with boundless energy. Born in Egypt, his family fled to the UK during the 1957 Suez crisis when he was twelve. He attended Oxford University and the Harvard Business School and did a stint at consulting firm McKinsey & Co. before becoming a legend of private equity investment as one of the founders of what is now known as Apax Partners. The list of companies which this independent global partnership has acquired or invested in is long and impressive. Ronnie remained the CEO of the firm until 2004.

But in the year 2000, he took on a new challenge: he became the Chair of the Social Investment Task Force established by the UK government with a mandate to "set out how entrepreneurial practices could be applied to obtain higher social and financial returns from social investment, to harness new talents and skills, to address economic regeneration and to unleash new sources of private and institutional investment". The idea that charitable, not-for-profit and foundation activities should be confined to eleemosynary purposes and kept distinct from gainful, business-like techniques, even in furtherance of their benevolent aims, was being challenged conceptually. The task force was to examine techniques to apply the tried and true methods of capitalist private enterprise to what had heretofore been seen as a world supported by the generosity of individuals and businesses as well as by the public purse but as antithetical to commercial pursuits.

The recommendations of the Task Force began the change in thinking which has since been fully endorsed and supported by successive United Kingdom governments. Beginning with his Bridges Ventures in 2002, an investor in sustainable growth projects which produce both financial returns and social and environmental benefits, Cohen went on to chair the Commission on Unclaimed Assets in 2005, which recommended that unclaimed funds in dormant bank accounts be directed to a social investment bank to provide seed capital and loan guarantees to charitable and voluntary sector projects.

Social Finance UK, founded in 2007 with a mission to create a social investment market, has developed the "social impact bond", an outcomes-based investment in community social projects. Its pilot venture in 2010 was the Peterborough Prison bond, under which the Government will pay, out of the resulting savings in the costs of incarceration, a return to private sector investors which escalates according to the rate of reduction in recidivism of a defined population of paroled and released prisoners achieved by the plan's managers.

In July 2011, Sir Ronald became the chairman of Big Society Capital (BSC), Britain's first social investment bank. The role of the BSC is to provide socially orientated financial organisations with greater access to affordable capital, using an estimated £400 million in unclaimed dormant bank accounts and £200 million from the UK's largest banks.

In 2011, a social finance organization was established in the US and, in 2012, in Israel. The Rockefeller Foundation granted Social Finance, Inc. $500,000 to develop a social impact bond market in the United States. The Foundation published "The Power of Impact Investing", in which its president, Judith Rodin, and Margot Brandenburg -- two of the foremost experts in the field -- explained what impact investing is and how it compares to philanthropy and traditional investments. Antony Bugg-Levine, a managing director at The Rockefeller Foundation, who also helped to develop the concept of impact investing, has written a book entitled, *Impact Investing: Transforming How We Make Money While Making a Difference*.

Australia was quick to pick up on this new concept, forming "Impact Investing Australia" and eliciting serious interest from asset managers in this growing field of investment.

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As awareness of social finance spread internationally, reaching to Latin America and the EU, UK Prime Minister David Cameron announced, in his capacity as Chair of the G8 in June, 2013, the launch of a taskforce with a mandate to catalyse a global market for investments that intentionally deliver social benefit. He appointed Sir Ronald Cohen to chair this Social Impact Investment Taskforce composed of the G8 countries, the EU and Australia. Each member country was asked to report on the state of play in its home jurisdiction.

In Canada, a Canadian Task Force on Social Finance had already issued a report in 2010 entitled, *Mobilizing Private Capital for Public Good*. The taskforce, which included notables from the fields of charitable activities, the voluntary sector as well as business and politics (including former prime minister Paul Martin), was supported by substantial backing from the McConnell Foundation and MaRS. Its landmark examination of how Canada could benefit from adopting the techniques of social finance has led to continuous discussions in policy and charitable sector circles, and to the appointment, first by Hon. Diane Finley and, more recently, by Hon. Jason Kenney, of a Ministerial Advisory Council on Social Innovation. In order to produce Canada's report on how adapting capital market incentives and techniques to charitable activities could provide much-needed resources to the voluntary sector and enhanced social outcomes, while easing the pressures on government to increase direct granting support to social service entities, the government appointed a National Advisory Board.

The advisory board's submission, presented in London, England on September 15, 2014, was entitled, *Mobilizing Private Capital for Public Good: Priorities for Canada*. It found that our laws, as currently reflected in relation to taxation and securities, do not facilitate the emergence of a concept that mixes inputs from benevolent motivations with those of the marketplace. Our treatment of the deduction of charitable donations is extremely generous, as noted by Jack Mintz in a recent article in the Financial Post ("CRA has been charitable", October 15, 2014). "In 2013, the federal tax cost of charitable donation credit is projected to be $2.2-billion", Mintz points out.

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But that results from a mindset that has the creation of wealth in a parallel universe to the dispensing of it through generosity, human kindness and compassion, for a charitable purpose. The idea that the principles of hard-headed business can be adapted to and incorporated into the regular activities of a thing we call a "registered charity" or a "charitable foundation" or that profitable ventures can assist in achieving the objectives of a not-for-profit organization, seems oxymoronic.

Thus, if we are to catch up to the lead of the UK, or be more welcoming to new concepts like the Australians, some fundamental changes to our thinking, and resulting amendments to our legislation, regulations and tax-assessing guidelines will be required.

For example, a charity is supposed to provide benefits to the public at large, or to a substantial segment of the public. It may not provide a benefit to private individuals. So, if a charity were dedicated to providing skills training to the chronically unemployed, that would be okay, so long as the charity did not actually contact a series of specific employers, ask them what skilled jobs they were having trouble filling, and work with them to develop a program where these very skills could be delivered to the population being assisted, since if they do the latter, they are providing a benefit to a handful of employers, because the program would be producing workers who would be filling an actual demand and become gainfully employed when the course is completed.

Similarly, charities lose their status if they engage in a business activity other than a "related business" which is run to the extent of 90% by volunteers or which is linked and subordinate to a charity's purpose. So a hospital can run a gift shop or a parking lot and apply the revenues to the hospital's budget. But a charity would run afoul of our laws if the commercial activity was more ambitious, even if the proceeds were all directed expressly to the good works for which the charity was founded. There is a very good reason for this: the concept of horizontal equity. Charities are not taxed and thus it would be unfair to a private sector, taxable enterprise to have to compete in its line of business head-on with a charity while the private entity paid income and other taxes.

The report outlines a solution, suggesting a hybrid standard where business activities beyond those currently tolerated by our system would be taxed, subject to certain *de minimis* rules, but the charity would not be exposed to losing its registered status.

The report makes a series of other useful recommendations, all of which share the same flavour: if Canada wishes to play in the new world of social finance, there will have to be some fundamental changes in thinking and approach so that we can unite the two separate worlds of hard-nosed commerce and caring, giving and helping.

Another example is that a charity is not supposed to make a below-market rate investment, even if this would advance their charitable objectives. For example, if a charity were to invest in a bond issued by a not-for-profit corporation constructing low-income housing, and take a "first loss" position in order to stimulate and encourage investment by others in the project, this would be offside and treated as a gift to a "non-qualified donee". Canada would need to modify its rules to permit this social investment technique.

Because our securities laws do not contemplate the issuance of equity or fixed-income securities by charitable entities or foundations, the use of limited partnerships is often resorted to as a way of facilitating a social investment for a public purpose. But because private foundations are prohibited from carrying on a business, and charities are discouraged from doing so by penalties, clarification is needed on this front to permit limited partnership investments by foundations and charities (a limited partner does not, by definition, participate in the management of the enterprise or venture).

In a second chapter, the report goes on to stress that governments can foster this emerging tool for achieving socially desirable outcomes by catalyzing opportunities for impact investing. In order to do this, some pump-priming initiative from government should be considered to kick-start private sector participation, such as a matching program paired with appropriate incentives, or the establishment of an outcomes payment fund.

In all, the report demonstrates how far we have to come to catch up to the decade-long evolution of social finance in the UK. And yet, there are glimmers on the horizon. Royal Bank of Canada has established the RBC Generator Fund, a $10-million pool of capital for investment in businesses that tackle social and environmental challenges while generating a financial return. KPMG has shown leadership on the emergence of impact investing principles among pension funds and other institutional investors.

Why would an investor dedicate a part of his/her or its portfolio to social impact investment? Well, the best businesses in our country already have elaborate and generous programs devoted to what is known as Corporate Social Responsibility. They are justly proud of directing part of their profits to helping the needy and communities. Why would they not embrace a concept that sees them doing as much, or even greater, good while earning a return, confident in the notion that the return arises out of the basic business principles of the efficient use of resources and the achievement of planned and predictable outcomes, leaving more resources to be allocated to even more good works?

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