



## **Moving Towards a Stronger Public Benefit Sector**

### **A Policy Blueprint for Strengthening Social Enterprise in the Province of Ontario**

**September 2014**

## About the Nonprofit Sector

Public benefit organizations – from arts and culture, sports and recreation, newcomer settlement, housing, faith groups and many more – reach almost all Canadians. Core nonprofit organizations in Canada (without hospitals, universities and colleges) generate \$35.6 billion or 2.5% of GDP. The core nonprofit sector is one of the fastest growing sectors of the economy with an annual growth rate of 7.1% nearly doubling from 1997-2008. Contrary to common perception, 45.6% of the core nonprofit sector's revenue comes from sales of goods and services, and an additional 15.9% comes from membership fees. Government transfers from the three levels of government comprise only 19.7%, with charitable donations at 14% with 4% other.<sup>1</sup> In Ontario, 88% of socially responsible businesses are operated by charities and nonprofits, 3% by cooperatives and 9% as for-profit corporations (4% of for-profit companies operate for a charity, with 5% as independent for-profit companies).<sup>2</sup>

## About Ontario Nonprofit Network

Organized in 2007, the Ontario Nonprofit Network (ONN) is the convening network for the 55,000 nonprofit organizations across Ontario. ONN engages, advocates and leads with- and for- nonprofit and charitable organizations that work for the public benefit in Ontario. As a 7,000-strong provincial network, with a volunteer base of 300 sector leaders, ONN brings the diverse voices of the sector to government, funders and the business sector to create and influence systemic change.

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<sup>1</sup> *The Satellite Account of Non-profit Institutions and Volunteering*, published by Statistics Canada in 2009.

<sup>2</sup> *Inspiring Innovation: The Size, Scope and Socioeconomic Impact of Nonprofit Social Enterprises in Ontario*. Canadian Community Economic Development Network, 2012.

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## Summary of Recommendations

***Social enterprises are those enterprises that provide a social good while generating income to undertake their work.***

In this paper, ONN looks at the big picture and establishes some key priorities for growing the social enterprise sector. The important contribution and potential of social enterprise has only recently begun to be understood and recognized. Social enterprise has not received the same attention as other business sectors and the unique needs of corporations who invest all revenues back into their mission for their communities has not been addressed.

The focus is on what are often called *nonprofit corporations* that operate as non-share capital corporations.<sup>3</sup> As nonprofit social enterprises make up 88% of social enterprises, ONN has focused on the immediate need to identify barriers and opportunities to creating a supportive policy eco-system for these public benefit, non-share capital organizations, their stakeholders and their investors. The regulation and legislation of non-share capital corporations need to be modernized to allow the nonprofit sector to develop more entrepreneurial strategies for their work. Additionally, these enterprises require creatively structured debt financing to allow them to grow their enterprises and build community wealth and resiliency.

Social enterprises are hugely varied and operate across a spectrum of corporate forms - charities, nonprofits, cooperatives, and for-profit businesses, all of which have their unique roles and strengths. Regardless of corporate form, all social enterprises exist to provide a public benefit, contribute to and grow community wealth and wellbeing. Social enterprises are increasingly important in this fast changing world and act as a bedrock of community stability. Performing arts, recreation and sport programs, supported employment, affordable housing and many other kinds of organizations earn income to support their work. Social enterprises constitute one of the fastest growing sectors of the economy.

**Social enterprise has the potential to address growing inequality in communities and play a major role in building community assets and resiliency.** This brief identifies key approaches and policy changes that will have an immediate impact on building social enterprise in the province.

These six key policy recommendations will be supported by a series of technical briefs that outline in more detail the specific changes needed:

1. **Approaches to stimulating and developing social enterprise should take a holistic approach and should be applied across the spectrum of social enterprises, regardless of corporate form.**

Innovation knows no bounds and cannot be programmed. In public benefit work, experiences shows that advances in building strong and resilient people and communities can and do come from a variety of stakeholders/people and organizations in communities. ONN supports the development of new ways of doing things, and encourages the development of supports to aid new and emerging innovations. Research and development funding similar to that received by other fields would be welcomed by social enterprises. Recent policy development for social enterprise has tended to focus almost exclusively on for profit or dual purpose (private profit and social good) enterprises, resulting in the discounting and neglect of the thousands of nonprofit organizations actually operating social enterprises in Ontario. The full spectrum of social enterprises needs appropriate legislative, regulatory and policy support to be able to get on with their work, raise funds, evolve and innovate.

**2. Modifications to the Ontario Business Corporations Act to provide for dual purpose “private profit and social good” corporations should not be undertaken at this time.**

ONN is supportive of any legislative framework that encourages and ensures enduring public benefit work. We understand that one size does not fit all, and different enterprises have different needs that require different corporate forms. However, the hybrid models, as currently constituted, do not seem to meet the needs of any of the key stakeholders: social entrepreneurs, communities, investors, or governments. Emerging evidence indicates that hybrid legislation models do not work for the purposes intended. More experience and close study of existing arrangements in this area would be beneficial before moving to legislation. Social entrepreneurs, investors and governments looking for blended returns (profit and social good) can currently undertake agreements and contracts under existing share capital corporate legislation. ONN recommends they be left free to experiment and evolve, documenting lessons learned in key cases. At the same time, the experiences of British Columbia and Nova Scotia, who are implementing different variations of the UK Community Interest Companies, can be watched.

**3. Approaches to social enterprise development must maintain a clear focus and clarity of purpose and principle.**

For policy development, it is critical to understand what makes a social enterprise fundamentally different from other businesses. The public, funders, and those working in the government, private and nonprofit sectors need confidence that social enterprises in their communities meet core criteria that demonstrate their commitment to the public good. The strength of social enterprise is in building community wealth – the infrastructure that we could not achieve individually, and to which all community members should have access.

ONN has identified the following four criteria that are key to the *public trust compact* that exists between organizations providing social enterprise and their communities, regardless of corporate form or sources of revenue:

- a. Has a **public purpose** and mission;
  - b. Operates for the **public good, not personal gain**;
  - c. **Reinvests excess revenue** in its public mission; and
  - d. **Retains its assets** in the public domain for the public good.
4. **The Government of Ontario should move forward with enabling amendments to legislation and regulation for the 88% of social enterprises operating as non-share capital organizations, so they may earn income to grow their enterprises, attract capital, and increase sustainability while maintaining the public's trust.**

Modernizing existing legislation and regulation to improve the ability of these organizations to raise essential operating revenues will also make these nonprofit corporate forms more attractive as corporate structures for new social enterprise. Nonprofit legislation and regulation was designed and developed in another era, before earned income was the largest, and growing, source of revenue for the sector. For example, 45.6% of the revenue generated by Ontario's community nonprofit sector is earned independent of government funding and donations.<sup>4</sup> There is a significant opportunity to modernize legislation and regulation to better enable this activity.

5. **The Government of Ontario should focus on improving access to appropriate capital investment across the different corporate forms that support social enterprises.**

Social enterprises have special challenges and needs that require different types and structures of investment capital. While modifications to existing legislation will bring much needed clarity to social enterprise work, access to capital should be addressed through non-legislative mechanisms. Increasing access to capital funds and investment formats that are well-designed, with the characteristics and needs of social enterprises in mind, can do much to grow socially responsible enterprises across diverse corporate forms. Enterprises need access to a wide variety of capital and supports at different stages of their development. Some of the changes are regulatory, while others are incentive-based. Key examples include slow money, pooled funds, crowd funding, community bonds, loan guarantees, RRSP eligibility for social investments, grants and tax incentives.

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<sup>4</sup> *The Satellite Account of Non-profit Institutions and Volunteering, published by Statistics Canada in 2009.*

## 6. The Government should develop a Social Procurement Action Plan.

The Government of Ontario has significant purchasing power. Procurement decisions, wherever possible, should provide a direct social benefit to Ontarians and their communities. Targeted social procurement, and the establishment of community benefit criteria for government purchasing, could significantly grow economic and community wealth creation opportunities for nonprofit social enterprises. This would build upon the Government's current efforts through the Ministry of Government and Consumer Services to analyze and replicate procurement processes and policies from other jurisdictions, such as the Scottish Government's leading work on public procurement reform.<sup>5</sup> A social procurement strategy must be developed in partnership with community, and ONN recommends drawing on the resources from community experts in the province's social economy who could provide leadership, guidance and province-wide linkages to help establish the plan.

### Introduction

*There are many conversations about social enterprise underway. There is talk of social enterprise, socially responsible enterprise, social purpose business, dual purpose corporations, community interest corporations, beneficial corporations, low profit limited corporations, flexible purpose corporations, social finance, impact investing... and the long-time standard forms of charities, nonprofits, cooperatives, grants, loans, and mortgages.*

ONN has been following all of the above, and takes this opportunity to pull it together to consider a holistic approach that makes sense for Ontario. While these issues and ideas are not new, they have typically been tackled separately. In this paper, ONN looks at the big picture and establishes some priorities for growing the social enterprise sector. Given nonprofit social enterprises comprise 88% of social enterprises in Ontario, we have focused on identifying barriers and opportunities to creating a supportive policy eco-system for nonprofit organizations providing public benefit, as well as their stakeholders and their investors. This discussion includes consideration of the range of legislative options for social enterprise. In 2013 the Government of Ontario identified a potential interest in exploring new legislation – a hybrid corporation intended to provide a social good and make a private profit.<sup>6</sup>

**Who is included in our definition of social enterprise:** We have defined socially responsible enterprises *as those enterprises that provide a social good while generating income to undertake their work.*

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<sup>5</sup> The Public Procurement Reform Programme, Government of Scotland.<http://www.scotland.gov.uk/Topics/Government/Procurement/about/Review>

<sup>6</sup> Impact: A Social Enterprise Strategy for Ontario For a strong economy and a fair society. Ministry of Economic Development Trade and Employment, 2013.

**These businesses are found within charities, incorporated as not-for-profit organizations, operating as cooperatives and operating under existing business legislation. Their focus is on building community wealth and assets that remain in the public domain.<sup>7</sup>**

## **Backgrounder on Public Benefit Organizations**

### **Public Benefit Organizations: Generating revenue, re-investing in mission**

It is important to understand the context in which these policy discussions are taking place.

Public benefit organizations – from arts and culture, sports and recreation, newcomer settlement, housing, faith groups and many more – reach almost all Ontarians. Core nonprofit organizations across Canada (without hospitals, universities, municipalities and colleges) generate \$35.6 billion or 2.6% of Canada's GDP. The core nonprofit sector is one of the fastest growing sectors of the economy with an annual growth rate of 7.1% nearly doubling from 1997-2007. Contrary to common perception, 45.6% of the core nonprofit sector's revenue comes from sales of goods and services, and an additional 15.9% comes from membership fees. Government transfers from the three levels of government comprise only 19.7% of revenue, with charitable donations at 14% and 4% other.<sup>8</sup>

In Ontario, there is some provincial data on social enterprises. A recent survey found 88% of social enterprises are operated by charities and nonprofits, 3% by cooperatives and 9% as for-profit corporations (4% of these are for-profit companies operated for a charity, and 5% as independent for-profit companies).<sup>9</sup>

What these data are telling us is that the long-standing sector of charities and nonprofits (55,000 of them in Ontario alone) is not waiting for a "handout." In fact, it's just the opposite: the nonprofit sector is comprised of independent organizations that make a significant economic contribution while pursuing their social missions. Between earned income and membership fees, these organizations raise 62% of their revenue. Another 20% of revenue comes from government as payment for delivering services that governments want for citizens and communities. Philanthropy adds a critical 14% to revenue streams, providing flexibility for charities to undertake work in communities addressing unmet and emerging needs.

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<sup>7</sup> As a different set of questions and considerations are required, this paper does not include business corporations engaged in philanthropic donations and/or corporate social responsibility initiatives as socially responsible enterprises. It refers only to the subset of businesses that have a social purpose as their core mission.

<sup>8</sup> *Imagine Canada; adapted from the Satellite Account of Non-profit Institutions and Volunteering published by Statistics Canada in 2009.*

<sup>9</sup> *Inspiring innovation: The Size, Scope and Socioeconomic Impact of Nonprofit Social enterprises in Ontario.* Canadian Community Economic Development Network – Ontario, 2012.



## **The credibility of social enterprise is built on a foundation of trust in public benefit work**

In the past decade there has been increased discussion of the need to grow social enterprises. This discussion often characterizes these social enterprises as separate and unique from other organizations providing public benefit. Depending on the speaker and audience, social enterprises have sometimes been described as business ventures operated by and for the nonprofit sector. At other times it has referred to for-profit ventures with a social mission, what in the United Kingdom is sometimes called “profit with purpose”. Currently, data show the vast majority of social enterprises (88%) are operating within the nonprofit sector.

The public does not differentiate between social enterprise and other work undertaken by nonprofit organizations. Even within the sector, many nonprofits do not explicitly identify their programs operating on earned revenues as social enterprises. They are simply doing what they do to achieve their mission. For example, the daycare, the local children’s soccer club, the nonprofit housing coop, the environmental business and the local theatre exist to build and enrich local community life in their own way. The public’s involvement and trust in charitable and nonprofit organizations has been created over many years through the committed work of millions of Canadians working in their communities with and for their neighbours. The strength of social enterprise is in building community wealth – the infrastructure and services that we could not achieve alone and to which we should all have access.

## **Seeking the best of all worlds**

Governments, faced with escalating costs and shrinking revenues, have been interested in the promise of “profit with purpose” organizations. The idea of for-profit enterprises doing good for communities, funded by private sector investors, has a strong attraction. The appeal of being able to do good and do well financially has caught the imagination of many. However, while the ideal is clear – the best of both worlds –achieving the balance needed for realistic, effective implementation is a significant challenge.

At the same time, proponents of the new hybrid corporate forms have positioned “profit with purpose” as implicitly superior to existing nonprofit social enterprises, representing the idealized blend of private and public good. At this time, these claims are not supported by evidence; indeed, there is emerging evidence that the distinct characteristics of hybrids may not be all positive.<sup>10</sup>

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<sup>10</sup> Ruth Cambridge, Hybrids, Hybridity, and Hype NPQ 07 May 2014, <https://nonprofitquarterly.org/policysocial-context/24150-hybrids-hybridity-and-hype.html>

Ontario data show that social mission organizations operating under business legislation currently comprise about 5% of social enterprises in Ontario.<sup>11</sup> In Britain, where such forms have been in place for some time, just 12% of social enterprises are operating as “profit with purpose” enterprises.<sup>12</sup> While a trend is emerging, thus far, there is no clear picture of what these businesses look like- what role they play in the spectrum of social enterprises, or how the profit and purpose motives can be balanced or integrated. Nor is it clear what kinds of social missions lend themselves to this corporate form and which do not.

It is early days in these shifts. There is much to learn and there are many changes needed. Some governments have focused on creating a new dual-purpose corporate form that will attract private sector investors. While these legislative initiatives are still in the experimental stage, to date investors have not participated as hoped. Moreover, up take of the new dual-purpose corporate forms by enterprises has been poor. Even in the United Kingdom where uptake has been greater, the vast majority of enterprises are operating without utilizing the share and dividend options that make the form ‘hybrid’.<sup>13</sup>

## **The spectrum of social enterprise forms – no one size fits all**

Finding ways to better support social enterprise requires an eco-system approach that encompasses the full spectrum of social enterprise activity. The prevalent “either/or” approaches that divide nonprofit and for-profit social purpose business are unhelpful. A realistic picture is lost when only nonprofits are discussed and, as is more often the case, when for-profit businesses are inaccurately presented as the only viable option for effective social enterprise. Hybridity as a concept and tool, as opposed to hybrids as a specific, new incorporated entity, has been part of the nonprofit sector for many years.<sup>14</sup> Public benefit organizations employ a number of strategies to achieve their mission and over the years have developed different partnerships, structures, operating models, sources of revenue and different corporate forms.

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<sup>11</sup> 4% of social enterprises using OBCA are operated by charities, 5% are operating as hybrids. *Inspiring innovation: The Size, Scope and Socioeconomic Impact of Nonprofit Social enterprises in Ontario*. (Survey data 2011), Community Economic Development Network

<sup>12</sup> *Changes to the Dividend and interest Caps for Community Interest Companies*: Response to the CIC consultation on the dividend and interest caps, [www.bis.gov.uk/cicregulator](http://www.bis.gov.uk/cicregulator), December 2013).

<sup>13</sup> For American data Bernholz, L. pg. 24. *The Annual Industry Forecast, Philanthropy and the Social Economy BluePrint 2014* available at: [www.grantcraft.org](http://www.grantcraft.org),

<sup>14</sup> Ruth Cambridge, Hybrids, Hybridity, and Hype NPQ 07 May 2014, <https://nonprofitquarterly.org/policysocial-context/24150-hybrids-hybridity-and-hype.html>

Organizations have long made use of hybridity in their work. Organizations such as the YMCA have long mixed fee-funded services with philanthropy and government funded programs, changing emphasis and focus as communities changed. Affordable housing has reinvented the second mortgage to "community" finance more housing; Habitat for Humanity has developed its ReStores (recycling construction materials) to support its house building; and Goodwill employs people at the margins to repurpose people's castoffs for resale at bargain prices. The sector knows how to blend, mix and repurpose to meet its public benefit mission.

## RECOMMENDATION

- 1. Approaches to stimulating and developing social enterprise should take a holistic approach and should be applied across the spectrum of social enterprises, regardless of corporate form.**

Innovation knows no bounds and cannot be programmed. In public benefit work, experiences shows that advances in building strong and resilient people and communities can and do come from a variety of stakeholders/people and organizations in communities. ONN supports the development of new ways of doing things, and encourages the development of supports to aid new and emerging innovations. Research and development funding similar to that received by other fields would be most welcomed by social enterprises. Recent policy development for social enterprise has tended to focus almost exclusively on for profit or dual purpose (private profit and social good) enterprises, resulting in the discounting and neglect of the thousands of nonprofit organizations actually operating social enterprises in Ontario. The full spectrum of social enterprises need appropriate legislative, regulatory and policy support to be able to get on with their work, raise funds, evolve and innovate.

## New Hybrid Corporate Forms: Context and Usage

Currently, there are two main approaches to dual-purpose corporate structures. The American model is to establish a corporate structure where the corporation declares its intent to undertake a social good in its objects (there are three variations on this approach in the United States). This is needed in the United States because of the success of shareholder litigation that makes Directors uniquely responsible for maximizing shareholder profit. Canada's context is quite different: Directors are not in a similar situation here. Even given the unique pressures faced by Directors in the United States, there has been little uptake of the new model<sup>15</sup> and concerns exist about the potential for misuse of the corporate form and brand. The American model is minimalist. It does not require any fixed contribution to the social good, nor does it define social good.

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<sup>15</sup> Bernholz, L. pg. 24. *The Annual Industry Forecast, Philanthropy and the Social Economy BluePrint 2014* available at: [www.grantcraft.org](http://www.grantcraft.org)

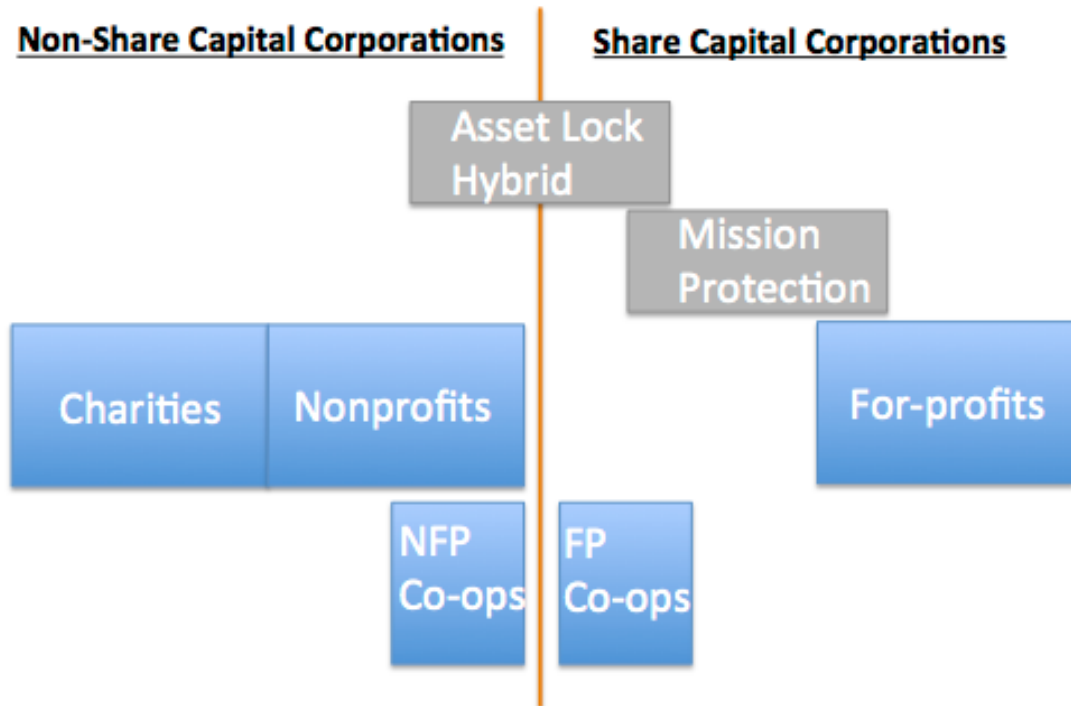
The United Kingdom's situation is more analogous to Canada as they have a similar public trust compact between the public, their charities and trusts. The United Kingdom's model requires the dual-purpose company, or Community Interest Company (CIC), to reinvest in its stated social purpose. The CIC initially proposed 80% vesting in mission and 20% paid to investors. Now this has shifted to require 65% public reinvestment and allow for 35% private profit. In addition, the government has just introduced a tax incentive for investment, as investors are not engaging as expected with social enterprises either in existing forms or this newer corporate form.

The United Kingdom's legislation has a regulator and regulates asset retention, limits on dividends and interest, and the social purpose (using a reasonable person test). Most of the companies (78%) operating under the United Kingdom's CIC legislation operate like Canadian nonprofit organizations. They have members, not shareholders, and use debt financing. This use may be attributed to the fact that the United Kingdom does not have the nonprofit corporate form that Canada has. Ten percent of CICs use shares that allow uncapped dividend payments to asset locked bodies (Canada has a similar provision for charities, which is capped at 75%.) Only 12% of CICs were using shares limited by the dividend cap.<sup>16</sup> It would be this latter group that would be accessible for private share purchases (in other words – a profit with purpose corporation).

These forms are shown in the diagram below, on a horizontal spectrum of legislated commitment for public benefit on the left, to private profit on the right. The blue boxes show, in short hand, the current corporate forms in Ontario. The grey boxes show the position of the two new hybrid corporate forms that exist in other jurisdictions. The "Asset Lock Hybrid" is the model used in the United Kingdom, and the "Mission Protection" model is used in the United States.

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<sup>16</sup> *Changes to the Dividend and interest Caps for Community Interest Companies: Response to the CIC consultation on the dividend and interest caps*, [www.bis.gov.uk/cicregulator](http://www.bis.gov.uk/cicregulator), December 2013).



Canada has a unique mix of corporate forms. It has charities, but it also has nonprofits and nonprofit co-operatives on the non-share capital side. These forms are deeply committed to reinvesting all revenues in their work. On the share capital side, there are for-profit co-operatives and business corporations. There is modern non-share capital legislation in the Canada Not-for-Profit Corporations Act (CNCA) and in Ontario, the Ontario Not-for-Profit Corporations Act (ONCA) (still to be proclaimed). There is also co-operative legislation.

Canada's business legislation, both federal and provincial, is flexible and can be tailored to achieve social purpose through shareholder agreements.

British Columbia has adopted legislation similar to the United Kingdom, but has opted not to have a regulator, and only requires the social purpose to be among the organization's many purposes. The British Columbia legislation has only been in place for a year and uptake is very slow (#11). It is far too soon to tell if it will be effective. In Nova Scotia, regulations are still being developed. Their version of the United Kingdom CIC model has a regulator. As the Nova Scotia legislation has not yet been proclaimed, its efficacy cannot yet be determined.

Given the low uptake of the model in the United States, and the adaptation of the United Kingdom CIC by 78% of users for entirely nonprofit purposes rather than a "hybrid" model, the efficacy of these new hybrid forms is questionable. While embodying an attractive ideal, the "hybrid" form risks satisfying no one. If it provides the flexibility wanted by social entrepreneurs, it provides insufficient accountability for the social purpose to satisfy governments, the public and investors. Yet to assure the social purpose requires so many rules and restrictions that entrepreneurs find it too cumbersome, and investors too limiting.

Jurisdiction	Social benefit purposes in addition to profit motive	Community Interest Test	Asset Lock	Dividend Cap	Reporting Requirements	Government Regulator	Tax credits
C3 (BC)	✓		✓	✓	✓		
CIC (NS)	✓		✓	✓	✓	✓	
CIC (UK)	✓	✓	✓	✓	✓	✓	April budget 2014
Benefit Corporation (US – 19 states)	✓				✓		
FPC (US – 3 states)	✓				✓		
L3C (US -9 states)	✓						

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Given that hybrid legislation is still very much under development, and British Columbia and Nova Scotia are experimenting in Canada, evidence suggests that a more productive route for Ontario would be to wait and see, while monitoring the other provinces and monitoring its own social enterprise development.

This would allow Ontario to focus on innovative approaches to enabling existing enterprises using the non-share capital form and improving the finance tools and products available for the full spectrum of social enterprises. Both of these initiatives can yield better and faster results for growing social enterprise, contributing to an enabling environment for social enterprise in Ontario and exemplifying successful strategies for use in Canada and beyond.

## RECOMMENDATION

**2. Modifications to the Ontario Business Corporations Act to provide for dual purpose “private profit and social good” corporations should not be undertaken at this time.** ONN is supportive of any legislative framework that encourages and ensures enduring public benefit work. We understand that one size does not fit all, and different enterprises have different needs that require different corporate forms. However, the hybrid models, as currently constituted, do not seem to meet the needs of any of the key stakeholders: social entrepreneurs, communities, investors, or governments. Emerging evidence indicates that hybrid legislation models do not work for the purposes intended. More experience and close study of existing arrangements in this area would be beneficial before moving to legislation. Social entrepreneurs, investors and governments looking for blended returns (profit and social good) can currently undertake agreements and contracts under existing share capital corporate legislation.

ONN recommends they be left free to experiment and evolve, documenting lessons learned in key cases. At the same time, the experiences of British Columbia and Nova Scotia, who are implementing different variations of the UK Community Interest Companies, can be watched.

## Clarity of Values and Purpose in Policy Development

Public benefit work is rooted in community values and as we develop new forms of operations, the outcomes desired must be clear. For example, a local organic cheese enterprise or new software application may provide public benefit that would allow for a sharing of public and private profit. There are many ways that all individuals and organizations can contribute to stronger communities. However, some areas of service require particular consideration. The structures of daycares, child welfare services or services for people with disabilities are better operated by non-share capital organizations that redeploy their revenues back into service.

There are many examples of privatization of services to the vulnerable resulting in poorer quality service and rising costs.<sup>18</sup> However, the idealization of private investment and the mistaken premise that making a private profit inherently makes an organization more effective is prevalent in many public policy discussions. It is also powerfully and persistently argued by prominent business-oriented groups.<sup>19</sup>

The United Kingdom is often cited as a country with examples of private sector solutions to government problems. However, serious concerns are being raised in the United Kingdom about the short and long-term impacts of profit motivations influencing child protection and other areas of community work.<sup>20</sup> There is no evidence that paying a profit margin yields better results. The United States Senate Committee hearings on social impact bonds illustrate this point.<sup>21</sup> They concluded “Privatization is not a panacea. Some of society’s challenges are inordinately difficult and while involving multiple partners to address them is essential, taking significant margins of revenue for profit reduces the funds available to address the issues at hand.”

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<sup>18</sup> Ruth Cambridge, Hybrids, Hybridity, and Hype NPQ 07 May 2014, <https://nonprofitquarterly.org/policysocial-context/24150-hybrids-hybridity-and-hype.html>

<sup>19</sup> Ontario Chamber of Commerce [http://www.occ.ca/Publications/Public-Sector-Problems-Private-Sector-Solutions\\_Electronic.pdf](http://www.occ.ca/Publications/Public-Sector-Problems-Private-Sector-Solutions_Electronic.pdf) <http://www.occ.ca/Publications/UnlockingPublicServiceEconomyOntario.pdf>

<sup>20</sup> <https://you.38degrees.org.uk/petitions/keep-profit-out-of-child-protection-1>

<sup>21</sup> <https://www.nonprofitquarterly.org/policysocial-context/24149-social-impact-bonds-not-well-received-at-senate-budget-hearing.html>

Social enterprises operating as non-share capital corporations bring to their work a common set of values and principles that are widely shared and understood. The public, funders and those working in the nonprofit sector understand that social enterprises in their communities meet core criteria that demonstrate their commitment to the public good. These criteria are key to the *public trust compact* that exists between these organizations and their communities:

- The organization has a **public purpose** and mission;
- The organization operates for the **public good not personal gain**;
- The organization **reinvests excess revenue** in its public mission; and
- The organization **retains its assets** in the public domain for the public good.

The clear, consistent and proven orientation towards public good is the distinguishing factor of the social enterprise. It is therefore critical that social enterprises operating under business corporate legislation adhere to the principles of a public benefit mission. If they do not, both the public benefit they purport to provide, and the trust that all social enterprises maintain with the public, is put at risk. Through cumulative effect, these risks weaken the structures of collective ownership that support healthy communities and individuals to effectively participate in democratic and market institutions.

## RECOMMENDATION:

### 1. Approaches to social enterprise development must maintain a clear focus and clarity of purpose and principle.

For policy development, it is critical to understand what makes a social enterprise fundamentally different from other businesses. The public, funders, and those working in the government, private and nonprofit sectors need confidence that social enterprises in their communities meet core criteria that demonstrate their commitment to the public good. The strength of social enterprise is in building community wealth – the infrastructure that we could not achieve individually, and to which all community members should have access.

ONN has identified the following four criteria that are key to the *public trust compact* that exists between organizations providing social enterprise and their communities, regardless of corporate form or sources of revenue:

- a. Has a **public purpose** and mission;
- b. Operates for the **public good, not personal gain**;
- c. **Reinvests excess revenue** in its public mission; and
- d. **Retains its assets** in the public domain for the public good.



## Legislative Choice

Experience has proven that different socially responsible businesses require different corporate forms and that having the range of choice is important. Ontario can have that choice if existing non-profit corporate forms, and charitable and nonprofit regulation under the Income Tax Act are modernized to better support social enterprise activity.

The ONN technical papers series will outline in detail the legislative amendments and regulatory changes required to support and enable nonprofit social enterprise in the following areas:

### **Ability of nonprofits to earn revenue to support mission.**

In Canada, there is clear evidence that nonprofits operating social enterprises need a more enabling environment for their enterprising activities. Recent audits by the Canadian Revenue Agency (CRA) generated uncertainty and concern for social enterprises with their statement that “a significant portion of incorporated organizations would fail to meet at least one of the requirements set out in 149(1) (l) of the (Income Tax) act.” Further, the auditors were surprised to find that many organizations believe that nonprofits must produce a profit to thrive and their capital assets to be maintained. In particular, there is a common view in the sector that as long as profits are used to further their organizations purpose, the source of the funding shouldn’t matter. CRA’s position, however, is different.<sup>22</sup> The profit of nonprofits must be only incidental and earning a profit to reinvest in mission is not permitted.<sup>23</sup>

### **Charities’ need to diversify revenue sources**

Charities are only slightly better off than non-charitable non-profits. Charities, with the exception of private foundations, are allowed to operate a “related business”; however, this is defined by the CRA as run substantially (90%) by volunteers or “linked” and “subordinate” to a charity's purpose. “Linked” is interpreted very narrowly and “subordinate” requires the business activity be a minor portion of the charities activities and resources.<sup>24</sup> For charities to be able to diversify their revenues to include social enterprises, regulations governing their ability to earned revenues need modernization.

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<sup>22</sup> Even though Paragraph 149(1)(l) of the Income Tax Act exempts organizations from income tax that are: “organized and operated exclusively for social welfare, civic improvement, pleasure or recreation or for any other purpose except profit, no part of the income of which was payable to, or was otherwise available for the personal benefit of, any proprietor, member or shareholder thereof ...”

<sup>23</sup> *Non-profit Organization Risk Identification Project* <http://www.cra-arc.gc.ca/tx/nnprft/qa-eng.html>

<sup>24</sup> Canada Revenue Agency (CRA), *Policy Statement CPS-019: What is a Related Business?* <http://www.cra-arc.gc.ca/chrts-qvng/chrts/plcy/cps/cps-019-eng.html#N102AD> (2003).

## **Modern Corporate legislation adapted to the needs of the nonprofit sector**

Fifty years after the last update, corporate legislation for the nonprofit sector in Ontario is in the process of being revamped. The Ontario Not-for-Profit Corporations Act (ONCA) is moving towards proclamation. While a vast improvement on the Corporations Act, a few relatively minor amendments are still needed to provide a clear framework for social enterprise. Modern and up-to-date corporate legislation for not-for-profit organizations is a sector priority.

Outdated legislation and regulations for charities, nonprofits and co-operatives is stifling innovation and growth, inhibiting nonprofit organizations from securing or enhancing their sustainability and limiting resources for their public benefit work.

### **RECOMMENDATION:**

**4. The Government of Ontario should move forward with enabling amendments to legislation and regulation for the 88% of social enterprises operating as non-share capital organizations, so they may earn income to grow their enterprises, attract capital, increase sustainability while maintaining the public's trust.**

Modernizing existing legislation and regulation to improve the ability of these organizations to raise essential operating revenues will also make these nonprofit corporate forms more attractive as corporate structures for new social enterprise. Nonprofit legislation and regulation was designed and developed in another era, before earned income was the largest, and growing, source of revenue for the sector. For example, 45.6% of the revenue generated by Ontario's community nonprofit sector is earned independent of government funding and donations.<sup>25</sup> There is a significant opportunity to modernize legislation and regulation to better enable this activity.

## **Enabling Accessible Capital**

Despite much discussion about investors eager to make money while investing their capital to address the challenging problems of our times, there are a number of barriers that prevent significant investment even in promising social enterprises. An article in a recent Stanford Social Innovation Review summarizes the issue well.<sup>26</sup> It appears that overall investors do not understand the nuances of social enterprise work and have difficulty evaluating risk. As a group they are also impatient with the slow pace of development and are reluctant to accept lower and delayed rates of return on their investments. Reconciling the expectations of investors with the realities of social development work is still a work in progress.

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<sup>25</sup> *The Satellite Account of Non-profit Institutions and Volunteering, published by Statistics Canada in 2009.*

<sup>26</sup> Rutherford R., Von Glahn D. *A Fault in Funding, Stanford Social Innovation Review*, Spring 2014.

Quebec is the one Canadian province that has been successful in facilitating investment in its social enterprises. It has accomplished this by concentrating on developing democratized community investment funds, rather than new corporate structures.<sup>27</sup> Even the United Kingdom, a leader in encouraging private investment in social good, has not yet found the formula to attract private investment.<sup>28</sup>

Some of the changes identified by the sector are regulatory, while others are incentives. Slow money (lower and delayed rates of return), pooled funds, crowd funding, community bonds, and loan guarantees, RRSP eligibility for social investments, grants and tax incentives have all been identified as helpful for nonprofit access to the capital needed.

Mainstream investors often appear to seek market rate returns, or are uncertain about the business case of public benefit organizations. In the face of these challenges, Quebec has harnessed investment funds that are satisfied with a steady return, not necessarily the top rate. They have also focused on bond opportunities in pooled funds allowing pension funds and individuals looking for ethical investments to have steady returns while supporting social good. To provide similar opportunities in Ontario requires nonprofit organizations to have access to streamlined security prospectus, clear exemption from securities dealer registration, RRSP eligibility for social bond funds, and loan guarantees. The accompanying technical amendments will outline the changes required to provide access to capital for public benefit corporations.

## RECOMMENDATION

### **5. The Government of Ontario should focus on improving access to appropriate capital investment across the different corporate forms that support social enterprises.**

Social enterprises have special challenges and needs that require different types and structures of investment capital. While modifications to existing legislation will bring much needed clarity to social enterprise work, access to capital should be addressed through non-legislative mechanisms. Increasing access to capital funds and investment formats that are well-designed, with the characteristics and needs of social enterprises in mind, can do much to grow socially responsible enterprises across diverse corporate forms. Enterprises need access to a wide variety of capital and supports at different stages of their development. Some of the changes are regulatory, while others are incentive-based. Key examples include slow money, pooled funds, crowd funding, community bonds, loan guarantees, RRSP eligibility for social investments, grants and tax incentives.

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<sup>27</sup> Dr. Marguerite Mendell.

<sup>28</sup> Burn-Callander, R. (2013) *Autumn Statement 2013: Social enterprises granted tax relief* [Online] Available at: <http://www.telegraph.co.uk/finance/budget/10498795/Autumn-Statement-2013-Social-enterprises-granted-tax-relief.html> [Accessed on 8 February 2014]

## Facilitating Social Procurement

As a method that adapts the market to support social and environmental goals, social enterprise entails a new way of thinking about how we buy and sell. Often the procurement practices and policies that were designed in the past to minimize cost for the purchaser and maximize profit for the provider did not consider the environmental and societal impact of procuring goods and services. The value added by requiring the bidder to include social and environmental commitments as part of the procurement processes adds to the return on investment for the province and local communities. Social procurement requirements are a key way for government to support social enterprises.

By incorporating a social impact deliverables in its procurement criteria, the Government of Ontario can play a leadership role in developing a robust market for social enterprise. In this way, the government can help to stimulate the economy, alleviate mounting pressure on its services system and catalyze grassroots economic activity without increasing its debt. In other words, the Government has an opportunity to get a greater return on the money it already spends.

### RECOMMENDATION

#### **6. The Government should develop a Social Procurement Action Plan.**

The Government of Ontario has significant purchasing power. Procurement decisions, wherever possible, should provide a direct social benefit to Ontarians and their communities. Targeted social procurement, and the establishment of community benefit criteria for government purchasing, could significantly grow economic wealth creation opportunities for nonprofit social enterprises. This would build upon the Government's current efforts through the Ministry of Government Services to analyze and replicate procurement processes and policies from other jurisdictions, such as the Scottish Government's leading work on public procurement reform.<sup>29</sup> A social procurement strategy must be developed in partnership with community, and ONN recommends drawing on the resources from community experts in the province's social economy who could provide leadership, guidance and province-wide linkages to help establish the plan.

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<sup>29</sup> The Public Procurement Reform Programme, Government of Scotland, <http://www.scotland.gov.uk/Topics/Government/Procurement/about/Review>

## Summary

Social enterprise is, at its root, a public benefit endeavor that accomplishes its work by raising revenues. Social enterprises are hugely varied and operate across a spectrum of corporate forms, all of which have their roles and strengths. Efforts to further develop and nurture social enterprise must ensure that regardless of corporate form, all social enterprises exist to forward a social mission, and contribute to and grow community wealth and wellbeing.

This Blueprint to strengthen social enterprise focuses on those legislative and regulatory changes that will provide immediate and clear benefits to existing and emerging social enterprises. The financial tools needed to help social enterprises obtain the investments they need have also been tested and succeeded elsewhere so we know they will yield dividends for Ontario communities. Social Procurement also has been implemented in other jurisdictions and if coordinated with the financial tools in Ontario will provide major stimulus for social enterprise development.

These significant and proven initiatives provide positive support to social enterprise development in Ontario. Other policy initiatives, however, are still in the experimental stage and ONN recommends Ontario keep watching briefs on them. Hybrid legislation is one of the initiatives that is still in the experimental stage.

ONN looks forward to working with the government and other partners to provide an enabling policy framework for Ontario's social enterprises.

## Technical papers

A series of technical papers is being developed to identify in detail the legislative and regulatory changes needed to support and enhance the development of social enterprises. Technical papers will also identify the financing tools and strategies needed to increase access to the capital products for the sector.

For more information about the technical papers and ONN's related work on social enterprise, please visit [www.theonn.ca](http://www.theonn.ca).