

APPENDIX A

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Introduction

...the greatest barrier to social entrepreneurship is adequate access to finance and an awareness of available sources of funding. (Source: TimesOnline, January 23, 2009)

The following report has been written as a reference for social enterprises and funders of social enterprises involved in agriculture and agri-food businesses. The report outlines the main funding options available for social enterprises and lists some of the organizations in British Columbia that fund agriculture and agri-food businesses. The report also includes a discussion of socially responsible investment (SRI) and its sub-sets; program-related investment and mission-related investment and briefly discusses partnerships and examples of funding partnerships in Canada.

Grants

Grants are most often provided to meet a charitable goal. Stated grant objectives generally fall under one or several of five categories: social, environmental, health, education and community economic development. A sustainable food system may impact all of them. For example, a regionally-based sustainable food system would:

- Improve the economic sustainability of small farm businesses
- Generate new community economic activity
- Generate manufacturing opportunities which may serve as an economic cornerstone for the community
- Generate new jobs
- Spawn interest and participation in agriculture education
- Provide the marginalized with access to healthy food
- Reduce the harmful impact of agriculture on the environment
- Reduce food waste
- Build community partnerships

As an example, the Columbia Foundation's mission is to "fund catalytic work to improve the quality of life within nature's ability to sustain it." One of the Columbia Foundation's three main focuses is to "create sustainable food and farming systems in California". Here is an example of the extent to which sustainable food systems objectives apply. From June 1, 2007 to May 31, 2008 the Foundation granted \$767,500 for the following purposes:

- To create a University Major in sustainable agriculture
- To protect and expand farmland through agricultural easements

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- To engage stakeholders in a visioning process for California's food and agriculture sector
- To increase collaboration and cooperation among environmental groups
- To strengthen the voice of farm labour in coalition work for sustainable agriculture and food systems
- To expand the "Buy Fresh Buy Local" into a statewide campaign
- To establish a multi-commodity sustainable-practices project
- To restore a river
- To develop a "Sustainable Food and Biomass Procurement Initiative"
- To educate the sustainable-agriculture groups about the need for sustainable water
- To host a public event focused on building a strong coalition for sustainable food and farming
- To create a "Buy Fresh Buy Local Food Guide"
- To publish a book, "The Bridge at the Edge of the World: Capitalism, the Environment, and the Crossing from Crisis to Sustainability"

Advantages of grant financing

- Usually do not have to be paid back
- Mirror investments
- Could be used to leverage additional funding and financing

Disadvantages of grant financing

Failing to provide sufficient long-term funding hobbles grantee organizations and limits foundations' own effectiveness. (Deitel, 2006, pg. 2)

- Usually only available to not-for-profit organizations
- Restrictive in use
- Usually modest in size
- May resolve short-term cash flow issues only. The grantee starts back in the same position the following year.
- Organizations compromise what they want to do in order to meet the terms of the grantor.
- Utilize a lot of staff time to write grant applications and follow-up reports

Granting Organizations in British Columbia

- The Federal Government, through Agriculture and Agri-Food Canada, offers numerous programs to support farmers and agri-food businesses.
 - Advance Payments Program: a financial loan guarantee program ([Advance Payments Program > Advance Payments Program > Programs and Services](#)) for commodity farms
 - Agri-Innovation Program (<http://www4.agr.gc.ca/AAFC-AAC/display-afficher.do?id=1175781996091&lang=eng>)
 - Business Risk Management Programs for large farms

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- AgriInvest: Producers make a deposit which is matched by federal funds to mitigate against the risk of margin declines. ([AgriInvest > AgriInvest Program > The New Business Risk Management Suite](#))
- AgriStability: Producers receive a payment when profit margins fall below a reference margin. ([AgriStability > AgriStability Program > The New Business Risk Management Suite](#))
- AgriRecovery ([AgriRecovery > AgriRecovery Program > The New Business Risk Management Suite](#))
- AgriInsurance ([AgriInsurance > AgriInsurance Program > The New Business Risk Management Suite](#))
- Canadian Rural Partnership Development Program: This program aims to increase collaboration and community capacity in rural and remote locations in Canada: [Rural Partnership Development Program > Programs > Rural](#)
- Co-operative Development Initiative: Designed to facilitate the development of cooperatives this program provides advisory services and funds innovation and research projects. ([Co-operative Development Initiative : General Information](#)) This program has recently been extended for an additional 4 years.
- Farm Improvement and Marketing Cooperatives Loans Act Program: A program designed to increase farmer access to loans for improvements and development of farms and the distribution of marketing or farm products by cooperative associations. ([Farm Improvement and Marketing Cooperatives Loans Act Program > Farm Improvement and Marketing Cooperatives Loans Act > Programs and Services](#)) This program has been re-designed and will be rolled out as the Canadian Agricultural Loans Act program—providing a loan loss reserve of 95% reducing risk for lenders
- The British Columbia Ministry of Agriculture (BCMAL) also offers the following programs:
 - Food Safety and Quality: [Canadian Food Safety and Quality Program - Food Safety and Quality – British Columbia Ministry of Agriculture and Lands](#)
 - Investment Agriculture Foundation of British Columbia delivers funding through a number of programs. [Investment Agriculture Foundation of BC](#)
- The Brainerd Foundation “protects the environment of the Northwest and builds broad citizen support for conservation. [The Brainerd Foundation - Funding Areas](#)
- BC Social Ventures Partners practice venture philanthropy. The organization supports the development of social enterprise through their multi-year granting program. Recognizing the equity finance gap, the organization also administers the BC Social Enterprise Fund (a partnership between Vancity, Vancouver Foundation and BEC Technology Social Venture Partners), a program that provides second-stage capital grants to social enterprises. As well as capital the organization provides business expertise to help social enterprises “develop strategies, secure funding, attract talent and communicate the mission”. [Apply for a Grant | BC Social Venture Partners](#)
- The Bullitt Foundation is currently seeking “high risk, high potential payoff opportunities to exert unusual leverage” to create sustainable, natural systems. It believes that Cascadia should lead the world in such pursuits. It is seeking partnership opportunities in projects that “promise to solve multiple problems simultaneously”. [Bullitt Foundation Vision — The Bullitt Foundation](#)
- The Canadian Environmental Grant-makers’ Network is an example of a funding collaboration. The network was developed to “help build the effectiveness of environmental funding in Canada.” It started out as an informal network of Foundations and was eventually federally incorporated as a not-for-profit organization. They have developed a profile of the Environmental Grant-making Sector along with an interactive search database of grants given. [Canadian Environmental Grantmakers' Network : About CEGN : Mission and Goals](#)
- The Centre for Sustainability hosts three funds: the ArtsPOD, EnviroPOD, and the SocialServicesPOD. The Centre’s main mission to develop capacity in BC’s not-for-profit organizations. [The Centre for Sustainability](#)

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- Coast Capital Savings' Community Investment Fund supports non-profit organizations and co-ops with a focus on social programs for low-income families, immigrants and youth. [Coast Capital Savings Credit Union - Community Investment Grants](#)
- The Coastal Community Credit Union also has a community program specifically for Vancouver Island. [Coast Capital Savings Credit Union - Community Investment Grants](#)
- Columbia Basin Trust focuses on local priorities and issues "to create a legacy of social, economic and environmental well-being and to achieve greater self-sufficiency for present and future generations." [Columbia Basin Trust](#)
- Community Futures/Western Diversification Rural Economic Adjustment Initiative has been established to respond to the slowdown in the forestry industry, the mountain pine beetle epidemic, the rapid increase in the value of the Canadian dollar and the slowdown the BC Fisheries. [Community Futures British Columbia](#)
- Sponsored by the federal government, the Canadian Co-operative Association provides advisory services and innovation and research grants to "study and demonstrate how co-ops can be used successfully in new ways". Innovative projects test and demonstrate innovative uses of the co-op model. The Co-operatives Secretariat is particularly looking at, among other things, "adding value to agriculture". They are also interested in projects that provide access to health and home care, economic development in rural, remote or Northern communities, development of Aboriginal Communities and community solutions to environmental changes. The program was to end March 31, 2008 but it may be a good idea to check in with them (1-888-781-2222) [Co-op Development Initiative | CoopZone](#)
- The Co-operators Foundation hosts a co-operative development fund. The foundation "provides financial assistance to social economy enterprises, emergent co-operatives, community economic development initiatives and other worthy causes in Canada". The four main criteria include health and sustainability, national scope, involves a co-operative board of directors and/or staff, & has broad community support. The foundation also has a community economic development fund to support community enterprise and initiatives "that create local employment and promote local self-reliance". [Cooperators.ca - Insurance/Financial Services](#)
- Environment Canada's EcoAction Community Funding Program supports projects that aim to reduce greenhouse gas emissions. [EcoAction: What is EcoAction?](#)
- The Habitat Conservation Trust Fund is in the process of restructuring and will be reestablished as the **Habitat Conservation Trust Foundation**. The organization funds conservation projects. [Welcome to the Habitat Conservation Trust Fund](#)
- VanCity Savings supports community initiatives targeting climate change, poverty, and social enterprise [Vancity - Program Guidelines and Criteria](#)
- The Vancouver Foundation is active in communities all over British Columbia. The Foundation focuses on eight key areas: animal welfare; arts and culture; children, youth and families; environment; health and social development; health and medical research; youth homelessness, and youth philanthropy. [Vancouver Foundation | Grants](#)
- The Western Diversification Community Adjustment Fund was established to respond to the current economic downturn. The fund aims to create jobs immediately and gives priority to single-industry communities. [Community Adjustment Fund](#)

Loans

Primary debt forms include traditional bank loans and lines of credit. Other debt forms include mortgages, asset-based loans, lease contracts, overdraft protection, supplier credit and credit cards. Loans may be accessed through domestic and foreign banks, specialized finance companies, crown corporations, trust companies, mortgage companies, life insurers, and credit

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card companies. Loan applications are evaluated based on pre-determined criteria and interest rates are set using the same or similar criteria. The main criteria are:

- The age of the business
- The industry sector
- The net worth of the owner
- The size of the organization
- The level of sales
- The bank's assessment of management capability
- The business plan
- The length of time that the current owners have owned the business
- The owner's or organizations' relationship with the bank
- Interest coverage ratios
- Whether or not the organization has other loans with the bank
- The size of the loan
- The size of the lending organization
- The number of account managers
- The amount of administrative effort required to issue the loan

Disadvantages of loan financing

- Borrowing increases the organization's systematic risk.
- Borrowing puts pressure on cash flows.
- Banks may be disinclined to lend to non-profit organizations due to the short-term nature of funding contracts.
- Banks usually require a corresponding equity investment.
- Start-up businesses may be subjected to formidably high interest rates.
- Banks may insist that the owner use personal equity as security for the loan.
- The lender usually does not have control over how the money is spent once the loan is issued.

Advantages of loan financing

Although loans increase a firm's risk, they also increase the organization's capacity to generate profit.

- Leverage is important for building sustainable businesses as its power is exponential in impact.

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- Some lenders may allow for flexible repayment terms to lessen the impact on cash flows. For example seasonal businesses may be allowed to make interest-only payments during periods of high cash outflows.
- Different types of loans may be used for different purposes. For example:
 - Asset-based lenders limit lending to tangible assets relying on the value of the assets as collateral. They place less reliance on debt/equity ratios and tend not to stipulate operating covenants. Capital and operating leases on equipment are included in this category. Small or start-up businesses will often access this type of loan because lower equity investment may be required. Food processors are good candidates for this form of debt due to their capital equipment needs.
 - Mortgages provide for longer repayment terms and the mortgaged property is used as security.
 - Mezzanine debt or subordinated debt is a type of loan but may also act as equity. Mezzanine debt is subordinate to claims on assets behind the mortgagor, lessors or bank loans (senior debt). It is usually provided to firms that are well beyond the start-up stage but not quite ready to go public. Mezzanine debt is often provided as a blend of debt and equity. Subordinated debt is separate from company working capital and conventional long-term debt and it does not dilute returns on equity. Mezzanine debt can be expensive. Typical rates of return are between 18 and 22%. Mezzanine debt is typically used for acquisitions, expansions and management buy-outs in place of equity capital.
- Loan guarantees facilitate lending to small business. As small loans may be as difficult or more difficult to manage administratively, loan guarantees take some of the onus off banks to perform the usual rigorous due diligence. An example of such an arrangement is through the Government of Canada's Small Business Loans Act which allows business start-ups to access small loans through traditional lenders.
- Micro-based and community development lenders provide entrepreneurs with technical and business planning assistance. As management ability is one of the main criteria that lenders evaluate, such lenders attempt to mitigate the risk by helping to build entrepreneurial capacity.

Lenders in British Columbia

- 1st Commercial Credit provides asset-based loans to food distributors using accounts receivables (factoring) and equipment as security. They also provide equipment leases. [First Commercial Credit Corp.](#)
- **AgriFinance**, a division of Western Financial Group, is another example of an asset-based lender. [Agrifinance Programs](#)
- The **Bank of Montreal** strives to be "North America's leading lender to the food industry". [BMO Bank of Montreal - Farm Business](#)
- The **Business Development Bank** of Canada provides a hybrid of debt and equity financing with flexible repayments based on cash flow rather than assets. The target is small to medium-sized businesses. The BDC also provides flexible loans with progressive or seasonal repayment options including the possibility of deferred capital repayments. [BDC Financing](#) [BDC | Business loans, Financing SME, Commercial financing, Canada](#)
- The **Canadian Alternative Investment Co-operative** provides loans to social enterprises and cooperatives, and also provides mortgages for community-based projects. [CAIC - Loan Application Process](#)
- The **Canadian Worker Co-op Federation** invests in worker co-operatives. They provide term loans, loan guarantees, and loans that are "preferred shares and common share equivalents". [Canadian Worker Co-operative Federation](#)
- **Coast Capital Savings** offers social enterprise loans. Loans are up to \$150,000 for applicants with an existing business that demonstrates benefits to the community's social or environmental well-being. Applicants must be members of the credit unit and demonstrate proof of their own contribution to the business (financial or in-kind). [Coast Capital Savings Credit Union - Social Enterprise Loans](#)

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- **Community Futures** Development Corporations operate independently in 34 communities across British Columbia. Their goal is to help diversify economies in areas traditionally economically dependent on natural resource industries. Community Futures organizations provide loans and technical support and often administer targeted community economic development programs sponsored by the federal government. [Community Futures British Columbia](#)
- **Farm Credit Canada** provides loans specifically for farmers and agri-food businesses structuring repayments to fit the seasonal nature of farm business cash flows. They loan operates like a line of credit: pre-approved, revolving, open variable rate and interest-only payments. Security is required but it can be real estate, quota or a general security agreement. They also offer loan life and accident insurance. [Farm Credit Canada - Products and Services](#)
- The **Farm Improvement and Marketing Co-operatives Loan Act (FIMCLA)** is a program that guarantees loans to farmers for farm assets such as machinery equipment building and land. FIMCLA applicants must be active farmers, who own or lease land that is currently being farmed. [Farm Improvement and Marketing Cooperatives Loans Act Program > Farm Improvement and Marketing Cooperatives Loans Act > Programs and Services](#)
- The **Royal Bank** provides a suite of financial services for farmers and agri-businesses. They provide services through farm specialists and include loans and support services for start-ups, expansion, and succession. [rbc.com - RBC - Corporate Responsibility](#)
- **Scotia Bank** offers a full range of financial products for farmers and agri-food businesses. [Scotiabank - Agriculture](#)
- **TD Canada Trust** also provides farm financing through regional agriculture specialists. [TD Canada Trust - Small Business - Agriculture Services](#)
- **Vancity** supports social enterprise in a big way. They have positioned themselves as the financial institution of choice for not-for-profit organizations. “For social enterprise being run as a for-profit business, we provide a range of investment advice and lending support” Vancity offers a full slate of banking services, loans and insurance. As discussed in the equity investment section, Vancity also offers subordinated debt to mirror capital investment. Loan terms are generally three to five years and amounts range from \$5,000 to \$1,000,000. [Vancity - Social Enterprises and Co-ops](#)

Equity Investment

The worldwide growth of social enterprise is threatened by a dearth of capital. Social enterprises need investment to grow and to innovate – investment that takes on the risk of the enterprise. This kind of capital cannot easily be pieced together from limited grants, conventional equity and ill-fitted debt. As increasing numbers of social entrepreneurs and mission-based financiers seek to enter the field, a question arises: can the sector develop new instruments and stakeholder relationships to meet this challenge? (Source: Emerson, Freundlich & Fructerman, n.d, Introduction)

It is most often expected that new venture entrepreneurs “put up the farm” to share in the risk of a venture. Equity is the base from which lenders and other potential investors calculate how much risk they are willing to take. Equity comes from two sources: investors and retained earnings. Start-up businesses usually have to source equity from their own personal wealth and/or from angels. Some community organizations have assets they could use for equity but this is often a real disadvantage for many community organizations and farmers groups looking to develop food system infrastructure.

Advantages of Equity Investment:

- An increase in equity decreases risk
- Helps to leverage debt
- May be used at management’s discretion

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- Does not drain cash when cash needs to be used for operational purposes
- The investor shares the risk
- The business is given an opportunity to scale-up.

Disadvantages of Equity Investment:

- The entrepreneur loses an element of control. For co-operatives this is particularly problematic because it undermines the “one member one vote” principle.
- The entrepreneur may be fired
- The investor takes a share of the profits
- In private corporations it may be difficult to liquidate the investment
- Investors expect high rates of return

Sources of Equity Investment

Angel Investors and Private Equity

Informal capital as provided by angel investors usually funds start-up and early stage businesses. The average size of an angel investment is about \$100,000. Angel investors include friends and family. Other angels are hard to find but they exist. A typical angel investor is:

- Self-made high income earner, well-educated and middle-aged
- Predominantly male, has entrepreneurial experience or is a wealth professional
- Prefers investing in his own locality
- Is experienced and confident in his ability to appraise investment opportunities
- Is opportunistic rather than scientific in making his investment decision
- Prefers to remain anonymous
- Angels may act alone or in conjunction with other angels.

It is estimated that the size of the informal venture capital market may be as high as twenty times larger than the institutional venture capital market, however the very private nature of angel investors makes the size a very difficult number to measure. Poor performance in the public equity markets has increased private equity investment. (Hatges, 2003)

Angels place high emphasis on:

- Managerial ability
- Business potential
- Integrity of the founders

Private investors tend to want control.

Entrepreneurs are turned away when their projections are unrealistic and when they are unwilling to forfeit control.

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Institutional Venture Capital

Institutional venture capital comes from private independent funds, government-sponsored or government-related sources, labour-sponsored capital companies and corporate parents. Canadian Pension Funds are beginning to participate as direct or syndicated partners. Institutional venture capitalists actively participate in the management of a firm. A lot of time and effort goes into the due diligence process, negotiations and on-going communication. The venture capitalist and the entrepreneur must develop a relationship of trust and confidence. Institutional investors are thus interested only in larger investments. An average investment is \$1 million. The key factor for these venture capitalists is management competence. According to Strandberg (2005) venture capitalists anticipate an 80% failure rate so they look for firms with very high short-term growth potential that will likely go public within a matter of a few years.

Entrepreneurs looking for investments from venture capitalists may believe that investment dollars are extremely scarce, however, Equinox (2002) has found increasing evidence that **suppliers of capital perceive a shortage of investment-ready opportunities.**

Social Venture Capital

Strandberg (2005) predicts the evolution of a new breed of venture capitalists willing to invest in locally-owned, geographically-based and community oriented social enterprises. Such investors will be looking at investment opportunities with slower, more sustainable growth that will remain privately held. Some lenders may consider providing a loan where repayment of principal is not required for an extended number of years. In this way a loan behaves as equity in that it does not drain the cash flows of the fledgling business. A specific timeline is usually set for when the investor will liquidate the investment and the amount payable is pre-determined.

Social Venture Funds as defined by Emerson (2003) invest in social enterprises using methods similar to venture capital funds in that the investors are highly engaged, the investment is patient, and the focus is on articulated outcomes. Social return on investment is measured and documented.

Key barriers to providing capital to social enterprises

- Insufficient capital markets and inadequate investment instruments
- High transaction costs
- Lack of adequate information flow
- Lack of market responsiveness
- Lack of connection between organizational performance and capital allocation
- Lack of common standards and definitions
- Lack of intermediation
- Lack of common understanding of relation between risk and return
- Fear of losing control
- Potential for mission drift
- Unfamiliarity with equity

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- Illiquidity
- Unacceptable risk/return trade-offs
- Lack of expertise to support management capacity

Structure

The British Columbia Equity Capital Program is designed to encourage BC investment in small businesses. The province provides a 30% refundable tax credit to investors in *eligible small businesses*. An *eligible small business* has no more than 100 employees, pays at least 75% of its wages and salaries to BC-resident employees and is substantially engaged in a “prescribed activity”. The proponent group must have \$25,000 investment money in hand before applying for ‘tax credit room’ for other investors to benefit from. This program often ‘sells out’ quickly but is one that holds good potential in communities where strong awareness can mobilize local investment.

Social Equity Investment Funds in British Columbia

- The **BC Social Enterprise Fund** (a partnership between Vancity, Vancouver Foundation and BEC Technology Social Venture Partners) is a program that provides second-stage capital grants to social enterprises. As well as capital, the organization provides business expertise to help social enterprises “develop strategies, secure funding, attract talent and communicate the mission. [Apply for a Grant | BC Social Venture Partners](#)
- The **Business Development Corporation** offers subordinate financing which is a loan but acts like equity. Loan repayments may be based on available cash flow and the BDC may participate in the company’s growth through stock options and royalties. [What you need to know_BDC | Subordinate loan and financing, quasi-equity financing for business, Canada](#)
- The **Co-operative Foundation** sponsors a Co-operative Development Program which promotes the development of new co-operatives. The foundation will consider investing up to \$25,000 in a co-operative in return for a minority shareholder position. It may require appropriate security. The Co-operators Group was formed by a group of farmers and provide of farm insurance. (Website currently offline)
- **Farm Credit Canada** offers venture capital financing directed at agriculture and agri-food businesses. FCC Ventures invests in industrial bio-products, food technology and nutraceutical ingredients in the growth-to-commercialization stages. [Farm Credit Canada - FCC Ventures](#)
- **RBC Capital Partners** provide mezzanine financing to North American companies “with a history of stable cash flows, experienced management teams and demonstrated competitive advantages”. RBC funded ABC Bakery, a company that specializes in manufacturing Artisan breads. [RBC Capital Markets - RBC Capital Partners](#)
- **Vancity Capital** provides capital solutions for social enterprises generally in the form of subordinated debt but they also help social enterprises to develop a viable financing plan taking into account grants in-kind contributions. Vancity may also bolster the plan with grants and allowances from their own organization. Lending criteria factors in community support and triple bottom line measurements. [Vancity - Vancity Capital](#)
- The **Working Opportunity Fund** (WOF) is managed by GrowthWorks and is one of two labour-sponsored investment funds sponsored by the British Columbia government. BC investors receive a combined federal/provincial tax credit of up to 30% when they invest in this fund. The Working Opportunity Fund invests in high-risk, high-growth technology, life sciences and advanced manufacturing companies. The WOF is a member of the Social Investment Organization and practices socially responsible investment in that they apply a screening process to all the companies in which it invests. [Venture Capital Management, Investment Funds Canada, Working Opportunity Fund](#)

Partnerships

Partnerships are fluid and may be set up for on-going operations or for short-term purposes. Partnership risk is similar to that of the entrepreneur, in that liability is not limited to the investment in the business. Other disadvantages are listed below.

Disadvantages:

- Partner differences in vision, direction, goals, and ethics
- Unequal commitment either in investment of time or investment of other resources
- Personal disputes
- Joint liability for debts incurred, decisions made, and actions taken by the other partner or partners
- Potential difficulty attracting other investors

Advantages:

- Partnerships provide a means of raising capital easily
- Partners can bring complementary expertise
- New partners may bring business contacts and networks, allowing the business to expand into new marketplaces or geographic areas.

Examples:

- The Little Potato Company started in 1996 on a one-acre plot near Edmonton. The company grows exclusive varieties of small potatoes. The Little Potato Company formed a partnership with MacKay and Hughes in Ontario to form The Little Potato Growers of Ontario. This partnership allowed the company to expand its operations into the East using the MacKay and Hughes management, logistics and infrastructure resources.
- FCC partners with a team of Crown Corporations (Canadian Commercial Corporation, Business Development Bank of Canada, Export Development Canada) to provide producers with financing options and services. FCC also partners with numerous suppliers to farmers such as equipment dealers to provide special-purpose financing such as equipment leases.
- Enterprising Non Profits is a partnership of 9 funders. [Our Funders and Collaborators | Enterprising Non Profits](#)
- BC Social Venture Partners is currently comprised of over 70 partners who pool capital and expertise to provide funding and technical support to social enterprises.

A good report to read that describes funding partnerships that are in place in Canada is called "Creating Capital Pools to Support Social Enterprise Development in Manitoba". The report was written by Alex Chernoff (8/20/2008) and is available on the ENP Website at [Resources: Papers & Reports | Enterprising Non Profits](#)

Socially Responsible Investment

This report would not be complete without a discussion about Socially Responsible Investment (SRI).

There will be niche sustainability funds differentiated on the depth of their sustainability analysis. SRI-type products that demonstrate they add value will be looked at and evaluated on their merits as another investment approach. Adopting a style of investing which marries

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social and environmental considerations into a single analytical framework at the outset, these funds will conduct deep research into a variety of companies and sectors to better understand the links between their sustainability efforts and future financial performance. These firms will provide a robust assessment of external factors that impinge on sustainability, identifying external sustainability trends that will affect corporate performance over time, while monitoring management performance relative to these trends. Some believe 10 years from now sustainability investing will have reached a high-water mark as a special style of investing, growing from being a niche SRI activity to being the leading edge of mainstream investing (Strandberg, 2005, Trends pg. 6)

The Canadian Association for Socially Responsible Investment publishes bi-annual directory of Asset Managers and Investment Consultants actively engaged in SRI. Engagement in SRI is increasing rapidly as evidenced by the number of directory items listed in 2006 (17) compared to the number of funds listed in 2008 (35).

In January 2000, MJRA launched the Jantzi Social Index®, a market capitalization-weighted common stock index consisting of 60 Canadian companies that pass a set of broadly-based social and environmental screens. Since inception, it has outperformed both the TSX Composite and the TSX/S&P60. (SIO, 2006, pg. 31 - Jantzi Research Inc.)

There is clear evidence that proactive social investments can yield reliable investment returns, preserve capital, and still provide significant social and environmental benefits. (Kramer & Cooch, 2006)

Case for SRI

- Shareholder Value
- Reputation Management
- Consistency between investments made and grants given
- Effectiveness
- Leveraging for Change
- Differentiation

Program-related Investment (PRI) is a subset of Socially Responsible Investment and is defined by U.S. tax regulation. Program related investments (PRI) as practiced in the US may be defined as:

- An investment rather than a grant (interest-bearing loan, equity)
- Made to an organization (usually but not necessarily a charity)
- Funded only through a foundation's endowment funds
- Primary purpose is to further the foundation's charitable purpose

U.S. foundations may include PRI's in their annual disbursement quotas. In Canada a form of PRI is allowed but Canadian tax law requires limiting the recipients of PRIs to qualified donees.

In making payments such as bridge loans or loans to community loan funds, the lending charity is carrying on a charitable activity of its own in promoting the efficiency and effectiveness of the recipient charity. As property "used directly in charitable activities", a foundation can thus deduct the amount of the loan from its investment assets, and accordingly

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reduce the part of its quota based on investment assets. At the same time, we will treat the opportunity cost to the charity in making the loan as an expenditure that it can apply towards meeting its quota. (CRA, RC4143 (E))

Under trust law a charity must be authorized by its objects to confer such a benefit (PRI) on another entity

Main strategies

- Invest core funds through advisors that are expert in MRIs.
- Provide secondary financing to loan funds
- Support an array of investment strategies that seek to create multiple returns.

Main characteristics

- Repayment is linked to success
- Debt service is minimized
- Investment is deeply subordinated
- Capital is patient
- Repayments are flexible
- A plausible exit strategy is formulated
- A contract is made between the investor and the entrepreneur agreeing to what constitutes value and the cost of doing good

Types of Instruments

Zero Coupon Bond

- Deeply subordinate to all other liabilities
- Removes debt service and defers compound interest
- Exit is firmly established in timing
- Possible flexibility to pay off the debt early
- Possible flexibility to demand repayment if certain benchmarks are not met

Preferred Shares

- Long rolling term
- Minimised debt service
- Flexibility
- Links to success
- Deep subordination
- A base coupon and structured interest payments and return of capital are stipulated but paid on successful attainment of specified benchmarks
- No maturity is stipulated

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Grant with a put

- Funders make a technically but only loosely recoverable grant
- There is no recourse to the assets of the enterprise
- Grants have to be repaid based on a success threshold which includes a premium

Revenue Rights structure

- Investors provide capital
- A certain % of revenue above a certain threshold is repaid

Examples:

F.B. Heron Foundation challenges the prevailing orthodoxy that

...mission is best served by constructing a "wall" between program and investment management, with the latter seeking to maximize financial return without consideration of mission and the former dispensing grants for mission. (F.B. Heron Foundation (n.d.), pg. 1)

The F.B. Heron Foundation found that there were sufficient community investment opportunities that aligned with their investment goals as well as their mission-based goals. By the end of 2003 19% of their endowment was invested in mission-related investments.

Their funding "toolbox" includes:

- Grants
- Insured and uninsured deposits
- Senior and subordinated loans
- Guarantees
- Fixed income securities
- Private equity

PRI's may offer below-market returns but most offer risk-adjusted market rates of return.

Established performance benchmarks for each asset class include:

- Benchmark for deposits is the national average for 2-year jumbo deposits as reported by BanxQuote.
- Benchmark for fixed-income securities is the Lehman Brothers Aggregate Bond Index
- Benchmark for private equity is the Venture Economics' US Private Equity Performance Index.
- Benchmark for PRIs is the long-term inflation rate +1%.

Requirements for a mission-related portfolio:

- A commitment to bring an investment discipline to all aspects of the work which requires training for investment and program staff.
- Creation of networks of third-party due diligence providers and investment advisors

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- Heightened engagement and learning for Board and Investment Committee.
- Costs offset by core holdings in index products
- Board focus on evaluating how effectively the program and investment activities complement the mission.

Foundation's mix:

- 65% equity
- 25% fixed income
- 10% alternative investments
- Total rate of return – 21.07% in 2003

Plans:

- Increased proportion of MRI's
- Partner with others to develop new products
- Grow the universe of institutional investors, including foundations, that make mission-related investments
- Work to increase the reliability and use of impact measurement systems

See the report “New Frontiers in Mission-Related Investing” (www.fbheron.org) for good examples of how F.B. Heron Foundation funds have been invested.

Conclusion

The main gap in social enterprise funding is equity. Social enterprises, if run by non-profit organizations, may have access to grant funding but such funding often comes with restrictions or parameters that limit needed flexibility and time frames are often too. Loan financing is available to social enterprises; however lenders tend to require security and will often require some percentage of equity investment. Equity investors tend to require some promise of high returns.

Non-profit organizations typically cannot build reserves large enough to launch or grow an enterprise and usually do not run enterprises can generate high returns. Socially responsible investing is seen as an answer to this problem and is gaining ground. Some foundations are finding that they can invest in social enterprises and achieve acceptable returns. Patient capital in the form of subordinated debt, flexible repayment schedules and payments based on performance mirrors equity investment and gives the lender a way to divest from the enterprise. Funding partnerships are being developed to share risk and expertise.

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