

## **Original concept**

When SCP was formed in early 2001, the original concept was to be a catalyst for large-scale social change in Canada by investing in great nonprofit organizations that had a system changing idea, visionary leadership and dramatic growth potential . Our initial investing strategy was based on a relatively new concept called venture philanthropy. Venture philanthropy is an approach for funding nonprofit organizations through the discipline of an “investment lens” as well as a philanthropic one. Venture philanthropists provide financing, and strategic and operational support, to those organizations that meet certain criteria for delivering measurable results.

Our concept was loosely modeled after New Profit, Inc., one of the most highly-regarded U.S. venture philanthropy organizations. Our plan, at the outset, was to look for innovative, growth-oriented charitable organizations with great ideas. We developed our investment criteria by which we could make our “investment” decisions (our grants). These criteria included:

- A great idea
- Visionary leader
- A commitment to sound business practices
- Scalable idea/organization
- Clear definition of success
- Limited dependencies
- Clear path to financial self-sufficiency

Having developed these criteria, we then went in search of one or two Canadian non-profits that could meet them. As it turned out, most of the organizations we examined could not meet our “limited dependencies” test. By this, we meant that we wanted to invest in organizations that had control of their own destiny and weren’t overly dependent on any particular funding sources or other organization, because achieving ambitious goals would be difficult enough without relying on other organizations to accept the performance-based funding principles at the core of venture philanthropy. The problem we encountered is described in the next section, Strategic Barriers.

## Strategic barriers

During 2001 we consulted with leaders in the Canadian nonprofit sector to identify innovative charitable organizations that could potentially meet our investment criteria. We talked to some 40 nonprofit organizations in the Toronto area, and conducted half-day strategy sessions with 10. SCP had hoped to find two or more organizations that met the criteria where SCP could invest both financial and intellectual capital, using its own resources and those of its strategic partners.

What we discovered was that our investment approach, as originally conceived, was not likely to be workable, given the strategic barriers that affect most existing Canadian nonprofit organizations, arising from heavy dependence on government funding. Our research indicated that, for several reasons, government funding and an increasing amount of foundation funding comes with very restrictive conditions on how that funding is to be used. While these conditions were originally intended to ensure that funds were used efficiently and properly, the net effect is that several social service organizations are forced to act in seemingly counter-productive ways in order to maintain funding sources.

### Some observations from our survey process:

- **There is plenty of talent and commitment in the Canadian nonprofit sector.** We met great, capable, committed people everywhere who despite not having the same kinds of financial rewards as the private sector kept persisting at their mission in the face of often very frustrating circumstances. The people and organizations were generally able to do a lot with a little.
- **Individuals in this sector are capable of doing a lot with a little because they have to.** Virtually all the organizations we reviewed had relatively weak balance sheets and low reserves. They were in perpetual scramble mode just to make ends meet.
- **As a result of weak balance sheets a disproportionate amount of a charitable organization's time and energy is devoted to fundraising.** We saw the social mission often had to take a back seat. Even when they were successful at raising funds, it was still difficult for them to accomplish their social mission, for the following reasons:
- **There is little funding of organizational capacity.** There seemed to be reasonable levels of funding available for specific programs or services. But capacity building was almost frowned upon as if it were an administrative expense contrary to the rules of good governance. So most operating charities had a myriad of separate programs funded by different donors, all of which had to be tracked and accounted for separately. Capacity-building funding, to integrate programs into a coherent strategy, was viewed as "wasteful".
- **Further, there's no funding for long-term outcome measurements.** Not one of the organizations we worked with could tell us much about their users or target populations two years after "graduation" from one of their programs. No funders saw this as a useful application of their grants. This lack of knowledge about long term outcomes means that: i) the charitable organizations really do not know if they are solving root cause issues or if the populations they serve slip back once the formal help is completed; and ii) there is no way to prove that they are more effective than other organizations attempting to address the same issue. Lack of support for long term outcome measurement prevents the establishment of a link between performance and funding, which means the good organizations don't necessarily get more funding and the poor ones don't necessarily get left behind. Success is measured only anecdotally and virtually all small and medium sized charities limp along.

- **Heavy dependency on government funding is also a problem.** This reflects the choice of most Canadians to be part of a socially progressive democracy, with a bigger social safety net but also higher tax rates than the US. It means, though, that we place a disproportionate reliance on government to be the principal funder of the social services sector. But government funding, by its nature, is typically short term (rarely more than a year at a time), slowed by bureaucratic decision making processes and is often subject to politicized agendas – not ideal for organizations trying to orient their operations to long-term goals.
- **Most non-government financing in the sector comes through a “donor lens”.** Most funding from other sources such as endowments and wealthy individuals tends to have conditions attached, that are more about meeting donor wishes than end user needs. These don’t always match.
- **As a consequence – the Canadian nonprofit sector has been forced to develop a core competency in tailoring programs to suit donor desires as opposed to focusing on unmet user needs.** Frankly many charitable organizations have become better at meeting donors’ needs than the needs of the populations they are trying to serve. They will willingly accept funds and tailor programs to donor’s requirements even if they only loosely fit the organization’s social mission. Sometimes it’s the only way to make payroll.

It was, and is, our belief that this condition cannot be easily remedied by the funding model that we had initially hoped to employ, and that a different model is required to create real change in certain parts of the sector.

## **Revenue generation through social enterprise**

Our current assumption is that traditional funding mechanisms and current program models do not suffice in delivering long term sustainable employment strategies for disadvantaged populations nor do they address the current, systemic financing issues in the Canadian social sector. We also realize that the original venture philanthropy principles we had hoped to use are not the answer. To overcome these challenges, we started to look for new ways in which to apply the venture philanthropy approach in Canada. It was this exploration that led us to the social enterprise model - otherwise known as social purpose or community businesses.

Social enterprises are businesses that use market-oriented production of goods or services to pursue their social mission. We are interested in social enterprises that help people develop sustainable livelihoods and develop paths towards self-sufficiency. The social enterprise model can be used to strategically create employment for disadvantaged groups in a “friendlier” business environment. Every “target employee” has a paid wage or salary appropriate to their work productivity capacity. Depending on the needs of target employees, additional skill development training is often provided and/or access to other services such as counseling, language training or help with finding stable housing. Some social enterprises will strategically keep wages low in order to reinforce to target employees that this is a steppingstone to better jobs down the road.

We decided to bet on this model and set up a process to work with organizations utilizing this approach. Instead of investing in programs and services intended to prepare people for the workplace, why not invest in those enterprises that hire disadvantaged groups while providing relevant social support services? Our hypothesis is that if you can create viable businesses that balance a financial bottom line while providing support services and employment opportunities for a marginalized or at-risk population, the opportunity would exist for social organizations to maintain more control over their destiny while continuing to achieve their social goals.

## Challenges

Below are some key issues and challenges specific to this model:

- **Succeeding at social enterprise is exceptionally hard.** Even in the Roberts portfolio – a leader in this area – there haven’t been many examples where achieving financial self-sufficiency and the social mission has occurred in tandem.
- **Chances for success are higher if the business and social mission are on equal footing.** Making a business succeed and achieving a social outcome at the same time is a tough balancing act. The Roberts experience has been that if either the social or the business mission always takes precedence, then success isn’t likely.
- **Chances of success are also higher if a businessperson with a good heart, as opposed to someone with a social services background, leads the organization.** The organization needs someone who brings a “Rolodex of contacts” and experience at making money and operating businesses, not to mention an enlightened attitude to applying private sector realities to nonprofit opportunities.
- **The leader of a social enterprise requires a peer resource in charge of the social mission.** It is tough enough to make business decisions – but who can handle the complexities and emotional turbulence involved in being the watchdog for the social mission? A division of labor and teamwork is required – a creative tension – between business and social aspects of the mission.
- **If a social enterprise is initiated within an established agency, it’s critical to set it up with a separate governance and pay structure.** Businesses typically operate on different dynamics than nonprofits. Mixing them is a recipe for failure, we found. An operational “firewall” is required to give the revenue-generating enterprise every chance for succeeding on the unique terms of its mandate, which might be different than the organization spawning it.
- **There is a high degree of burnout of social enterprise leaders.** Getting a social enterprise off the ground requires that leaders undertake an immense amount of work overcome significant challenges. A high level of burnout among the leaders of these organizations indicates how hard it is, even with the best of intentions, to make these enterprises succeed.
- **Many of the social enterprises in Canada are essentially “training labs” and not real businesses.** Training labs serve a function but they only “simulate” the work experience, not provide the actual thing. As well, since government funding is often provided in correlation to the number of people an organization hires, sometimes there are more people on staff than needed, which can put unneeded stress on a business. Adhering to funding criteria for obtaining trainees can force managers to operate bureaucratically, which is part of the strategic straitjacket that prevents them from controlling their destiny.
- **You can’t be all things to all people.** Too often, social enterprises get started without a clear idea of who can benefit from the undertaking. People employed in these social enterprises require enough adaptiveness to hold down a job. A social enterprise model can, in essence, only really help job-ready people. It’s important to segment your users – clearly understand what you are doing and with whom. What kind of employment barriers do people have and why? How many hours per week can they work?

What skills do they possess and what kind of skills would they like to learn?

- **It is an ongoing challenge to create a supportive work environment with realistic expectations of target employees.** The key to managing this challenge is trust; trust among all individuals involved in the social enterprise.
- **This model is not a savior for all of our society's social issues.** Social enterprises may not be able to solve the deepest, most intractable problems – it's not a solution for every situation and cannot replace the need for traditional agencies. People with significant mental illness, serious drug problems, or other issues that inhibit "job-readiness" are not ideal candidates for these organizations. This begs the question: how much can one achieve within this model?
- **Success depends, we believe, on being responsive to three criteria:**
  - **Social outcomes** – What kinds of social enterprises are likely to succeed and will the results be worth the investment? For example -- are people working in teams or in relative isolation, like a virtual call centre? Do the jobs created point to a sustainable future by developing skills that can lead to higher-value employment down the road? Do they provide personal as well as professional development?
  - **Financial outcomes** – How close to financial self-sufficiency can an organization become? An important issue is: what is the capital to labor ratio? High labor businesses are favored, given that more people can be involved per dollar invested. Ironically, high-labor businesses that are not attractive to private sector investors might be best suited to nonprofits, including commodity businesses.
  - **Consumer acceptance** – Can the social mission, particularly in a commodity business, be a competitive advantage? Can it be scaled or branded to succeed by getting consumers to switch in support of "good works"? Can the business be differentiated because it has a social mission?