A Fine Balance:

What Inner City Renovations taught us about managing social and economic objectives inside business models

What are reasonable profitability targets for a start up social enterprise with the mission to create employment for disadvantaged populations? How does external financing play a role in the execution of the social mission and how does a social mission as a key part of the business model impact the ability to reach profitability targets? This article showcases one of SCP's early investments and highlights key learning about the inherent mission tensions inside these business models.

SCP's Beginnings

Social Capital Partners was established in 2001 with the mission to invest in businesses with the two-pronged vision of becoming profitable while providing employment opportunities for disadvantaged populations. These types of businesses are often called social enterprises.

We knew that in order to understand the "blended value" (social and financial) of these kinds of investments, we would need a different kind of measurement tool to help us and our portfolio organizations understand their unique value creation. We therefore developed an SROI (social return on investment) report card template – learning and borrowing from the experience of the Roberts Enterprise Development Fund, based in San Francisco – for our initial "purpose built" social enterprise investments. For all of our early social enterprise investments we produced annual SROI reports that highlighted qualitative and quantitative information about the target employee group being hired, business achievements and financial outcomes for the given year.

This report is less focused on the particular SROI methodology we used and the reports we produced, and more about how this kind of reporting, combined with being an "engaged" investor, challenged many of our early assumptions about when and how these kinds of businesses should meet certain milestones. In short, we learned a lot.

In this portfolio we worked particularly closely with a start up social enterprise based in Winnipeg, Manitoba, called Inner City Renovations. What we learned from this experience, and from working closely with the local investor organization Community Ownership Solutions, is the focus of this report.

Early Assumptions

Our initial assumption was that if purpose built social enterprises had access to appropriate financing that enabled them to increase their financial results (e.g. grow sales and improve profitability), this would have a corresponding net benefit to the social purpose of the business – e.g. enable them to recruit more "social hires"[1] into the business and therefore increase the social return on the initial investment. We assumed that this would be a positive correlation. Through this first investment phase, we learned that this assumption was not necessarily so, as it depends on a variety of factors.

SCP started working with Inner City Renovations (ICR) in 2002. ICR provided us a fantastic opportunity to learn about the different levers or mission tensions inherent to social enterprise ventures. Through our collaborative work with ICR and Community Ownership Solutions (COS) – the organization that launched ICR – we were able to dissect our initial assumptions and become more educated about the relationships among social enterprise profitability, social hiring and social return on investment.

The following report gleans our learning from ICR's first three years of operation (2002 – 2005) when SCP was an active investor and advisor to the business. The last section discusses the rationale behind our conclusion that we were the wrong partner for ICR, why we stayed on as an advisor, and how this experience influenced our strategy going forward.

Big Vision Set the Stage

COS, along with 4 not-for-profit housing organizations[2] identified a niche business opportunity; launch a renovation company that employs local residents to complete the renovation services needed for their housing projects. The initial concept for ICR was born. One of the housing organizations had also been running a carpentry training program for local residents. This training group became part of ICR's first group of employees.

ICR's social mission was to provide full-time employment, better than average sector wages with benefits and access to training for low income, inner city residents of Winnipeg. This vision went against the pre-dominant business model in this industry sector; hiring people on contract, at the lowest wages possible, with no benefits and on a per project basis.

During this first year, we learned a lot about the consequences of hiring a predominately unskilled workforce at above average wages, some of whom were also dealing with significant personal issues. This combined with high, fixed overhead led to significant cost overruns. The renovation business is complex and demands a mix of skilled, semi-skilled and unskilled workers. It also requires significant sophistication, expertise and knowledge to bid on and estimate the work and timelines for specific projects. We learned that we needed to get better at matching the technical skill sets of target social hires to the skills needed on particular jobsites. The business was not going to stabilize and lay the foundation to grow if there was not a better match between the 'job' and the 'skills' an employee needed to do the job.

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[1] Social hires are job ready graduates of pre-employment training programs delivered by community-based agencies.
[2] North End Housing Project, Winnipeg Partners in Housing, Spence Neighborhood Association and West Broadway Development Corporation

ICR grew quickly in its first year (from 7 to 26 employees) and approximately 85% of the employee group was target/social hires. ICR's social hiring was saving the government approximately $150,000 annually in decreased dependence on income assistance. An impressive feat in itself, however, the first year also ended with a significant operating loss and needed both grants and loans to keep it going.

Despite a challenging first year, total sales revenues reached close to a million dollars ($935,000) and at year end, turnover was beginning to stabilize. Job site crews were also positioned to be more productive. We had lost more money than we had planned and had to make some difficult choices but we still firmly believed ICR would be able to improve profitability while maintaining its social mission.

The Social Cost of Improving Profitability

The primary focus for year two was improving ICR's financial results. A key indicator for this was ensuring that projects met approved budgets and did not go over completion timelines. In order to do this we had to make some difficult mission trade-offs; including hiring more skilled workers and job site supervisors. In order to stabilize the business, we needed to have an efficient mix of supervisory, skilled, semi-skilled and unskilled workers at each job site in order for projects to meet timelines, come in on budget and stop losing money. The result of these changes meant that we could not afford to hire inexperienced workers and were not opening up slots for new social hires who had the interest in building a career in this industry but lacked the requisite skills.

We also had to reassess our wage scale and create market based wage ranges based on different categories of skill levels. Finally, we set the target social hiring ratio to a range that better fit the needs of the business; from 80%–85% to 60%-65% of the total employee base. We believed that a 60 – 65% target social hire ratio range would still enable ICR to reach its profitability targets while maintaining its commitment to create jobs for low income, inner city residents.

The financial results did improve. By the end of year two the operating loss had decreased by $89,000 and the total investment required had decreased to $225,000 from $368,000 in year one. These financial results were necessary to continue to build ICR's business viability and maintain the goal of becoming a profitable company within a three year timeframe, but they came at a social cost.

ICR generated almost exactly the same amount of sales revenue as in year one ($936,000) but with a significantly smaller number of social hires as part of the total employee group. The average number of social hires decreased from 18.5 in year one to 9 in year two. Therefore, we had improved the financial viability of the company, but at the expense of the social mission. This outcome was very different than our original assumption that we would improve our total social returns – create more jobs for target social hires - as the financial returns got better.

Questioning Our Assumptions

By year three, ICR had worked out the most effective jobsite crew make up to meet project completion deadlines and provide the necessary on-the job training for new and existing social hires. ICR's model of training required a significantly higher ratio of qualified trades people to trainees - 2 trainees for every 1 journeyperson, whereas ICR's competitors would have a ratio closer to 5 to 1. This put ICR at a competitive disadvantage which was reflected in ICR's accumulated losses and continued need for grant funding to pay for the additional training.

Approximately one-third of ICR's social hiring group had been with ICR for a year or more and their improved skills and experience was reflected in their increased productivity levels however, they still required some ongoing training and extra supervision. ICR's newer social hires needed significant training and supervision. Compared to year one, training costs had definitely decreased and were continuing to do so, but not at the rate we had anticipated.

It was during year three that ICR was formally recognized by the Winnipeg aboriginal community as a business connected at the community level. ICR has been employing inner city, aboriginal residents since its inception and continues to do so. This recognition was a honor for ICR and provided an opportunity to reflect on ICR's achievements; one being becoming the major contractor for commercial and renewal projects in Winnipeg's inner city, particularly Selkirk Ave. ICR literally was building livelihoods and neighborhoods at the same the time.

Through this experience we learned about the importance of the skills/training gap; the difference between the skills of the people being hired and the requisite skills needed to make the business successful. Initially we believed that the training costs would be less and productivity levels would increase faster.

By the end of year 3 ICR had increased its total revenues 37% from the year before to $1,478,000 and had grown commercial revenues from 30% to 50% total revenues. Through this growth ICR was also able to increase the average number of social hires to 14 from 9, maintaining a social hire ratio of 63% of the total employee group. These combined outcomes were a significant achievement on both of ICR's bottom lines, however, now that we had much deeper understanding of the operational reality of ICR's business we began to seriously question our initial assumptions concerning when ICR should reach profitability.

Reality Sets In

It was at this point that we came to three conclusions:

1) If we continued to push ICR to reach profitability ICR's ability to execute on the social hiring mission would significantly decrease;
2) We would help ICR find a different partner that could provide the funding to offset the additional training costs; and
3) SCP needed to reflect on our own investment strategy and capacity constraints going forward to determine what kind of businesses we would engage with our financing.

When we first invested in ICR we did not have a thorough understanding of the different factors involved in these types of enterprises. Three years in, we realized the naivety of our initial assumptions. Through this experience and other early investments we made in purpose built social enterprise, we identified 5 major factors for consideration in order to set reasonable profitability goals for different kinds of social enterprise ventures. We realized that social enterprises operate on a continuum and profitability goals need to be realistically set within the context of the:

1) Inherent business capacity of the social enterprise (management sophistication and financial capacity)
2) complexity of the business
3) size and nature of employment barriers of the people being hired;
4) skills/training gap of the people being hired and skills needed to do the job
5) degree of emphasis on the social mission in day to day decision making

For further detailed discussion of these factors please see another publication authored by SCP titled "The Five Critical Factors of Social Enterprise Profitability".

Working with ICR we learned that the renovations business is complex; it demands a high degree of customization on a per client basis, specialized training and industry knowledge and significant project management expertise. Combining this with ICR's commitment to hiring inner city, low income residents – many with low education and no related employment experience – meant that the training and supervision costs for hiring this employee group were much higher than a similar business without this social mission.

Setting out with an SROI reporting process and methodology provided us with a measurement tool for ourselves and our portfolio organizations to better understand the blended value of our investments but more importantly it helped us realize that profitability targets and timelines need to be realistically set within the social and financial objectives of the enterprise.

ICR had a 3 year history to present to other funders to make the case for an ongoing training grant and had the data (annual SROI reports) that demonstrated the blended value of the enterprise. SCP believed strongly in ICR's mission and vision and was committed to stay on as an active advisor but we were not prepared to continue to fund the losses of ICR. It was at this point that ICR (through COS) established a funding relationship with the province of Manitoba for a training grant to offset the additional training and supervisory costs of employing the target group. This relationship was followed by additional funding support from the other granting bodies such as the Winnipeg Foundation and United Way Winnipeg.

Today, ICR continues to thrive and is recognized as a leading social enterprise in Canada and internationally. ICR continues to hire the majority of its employees from the inner city of Winnipeg and operates on a break even or better basis with the support of external funders to offset the additional training and social support costs of hiring the target employee group.

SCP's Move to Franchising

Our experience working with ICR made us realize just how difficult these kinds businesses can be to get off the ground, let alone scale. ICR is a social enterprise success story; it has proven that a business environment can be an effective strategy to help a significantly disadvantaged population establish an independent income and develop a sustainable livelihood, however, similar types of investments were not going to enable SCP to establish a sustainable loan portfolio or engage the broader private sector in the practice of social hiring. SCP also had to identify investment opportunities that fit within our own capacity and resource constraints. It was this reflection that led us to the world of franchising.

Investing in franchises would mitigate many of the risks associated with starting a new venture and allow us more time to focus on helping the companies establish social hiring programs that fit with their business needs and career aspirations of the target hiring group. We would evaluate franchise opportunities on things such as job quality and labour intensity, similar to our earlier investments but we would also have a built in opportunity to scale by setting up customized loan programs linked to social hiring targets with corporate franchisors.

We established our first franchise relationship with Active Green and Ross (AG+R) – one of southern Ontario's largest chains of tire and auto care centres - and made our first franchise investment in Hamilton, Ontario in early 2006. Today we have loans with 23 AG & R locations across southern Ontario. In this approach, SCP operates like a broker or intermediary on behalf of our franchise investments. We do all the upfront engagement and marketing to the local community programs/agencies that help people with barriers to employment get back into the workforce. A key value we provide is the assessment of the community employment agencies that can best deliver the profile of employees our franchise investment requires.

We now have established relationships with other franchise systems in the automotive service industry interested in establishing programs with us and are testing social hiring pilots in other industries such as home health care.