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Social enterprises in OECD Member
Countries: What are the financial
streams?

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"Social enterprises in OECD Member Countries: What are the financial streams?"

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Presentation of ARUC-ÉS and RQRP-ÉS

The *Alliance de recherche universités-communautés en économie sociale* (ARUC-ÉS - Community-University Research Alliance in Social Economy (CURA-ÉS) and the *Réseau québécois de recherche partenariale en économie sociale* (RQRP-ÉS - « Quebec network of Research Partnerships in Social Economy») are research partnership centres funded by the Social Sciences and Humanities Research Council of Canada. Together, they form a research consortium on issues of common interest, namely, researching and mobilizing knowledge in the area of the social economy. The activities of this consortium have enabled the social economy to grow and earn broader recognition as a social, cultural, political and economic development instrument in Quebec.

The ARUC-ÉS, which was created in 2000, is Quebec's first centre for interuniversity research devoted entirely to research partnerships. Its activities focus on different sectors of the social economy: community housing, social services, recreation and social tourism, finance and local and regional development. For its part, the RQRP-ÉS, which was created in 2005, is one of six Canadian centres dedicated to research partnerships in social economy. It is geographically decentralized: the RQRP-ÉS is active in eight Québec regions with a university, and its research focuses on the distinctive features of each region.

The two Montreal-based research centres are both located at Université du Québec à Montréal (UQAM).

Abstract

This chapter focuses on the emergence of financial instruments and enabling environments for social enterprises (SEs) in selected OECD countries, with particular attention on Western European countries, Canada and the United States, and possible strategies for supporting their development in Eastern European Countries. As social enterprises continue to draw the attention of national governments and local authorities alike in the fight against unemployment and social exclusion, they are also being embraced by civil society as a way of addressing unmet needs in a sustainable manner. Social enterprises are emerging in numerous sectors producing goods and services, increasingly demonstrating their capacity as economic actors. They are similarly considered as key to socio-economic transformation in transitional economies.

As the chapter suggests, the incompatibility of an existing investment framework tied to outmoded and fixed categories that do not correspond to the new reality of social enterprises and their investment needs, requires cultural adaptation of the financial, legal, accounting and policy communities internationally to this new reality before the appropriate and enabling tools can be designed. For social finance to become sustainable finance, an integrated approach has to be adopted that is distinct from traditional capital markets.

In conclusion, and regardless of the breadth of instruments available, the real potential of social enterprises will only be realized if they are integrated into a systemic approach to social exclusion, labor market transformation, and territorial (place-based) socio-economic development strategies that requires innovative public policy.

Key-words: financial tools, sustainable finance, social finance, social enterprises

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List of Common Acronyms

APO	Alternative Public Offering
CIC	Community Interest Company
CDFIs	Community Development Financial Institutions
CLO	Collateralized Loan Obligations
CRA	Community Investment Act
EPO	Ethical Public Offering
ETI	Economically Targeted Investment
MFI	Microfinance institutions
MI	Mission Investing
MRI	Mission-Related Investment
PRI	Program-Related Investment
SE	Social Enterprise
SEE	Social Economy Enterprise
SRI	Socially Responsible Investment
SRoI	Social Return on Investment
SVP	Social Venture Philanthropists

Introduction

This chapter focuses on the emergence of financial instruments and enabling environments for social enterprises (SEs) in selected OECD countries, with particular attention on Western European countries, Canada and the United States, and possible strategies for supporting their development in Eastern European Countries. As social enterprises continue to draw the attention of national governments and local authorities alike in the fight against unemployment and social exclusion, they are also being embraced by civil society as a way of addressing unmet needs in a sustainable manner. Social enterprises are emerging in numerous sectors producing goods and services, increasingly demonstrating their capacity as economic actors. They are similarly considered as key to socio-economic transformation in transitional economies.

For social enterprises to emerge and to consolidate their activities, they must have access to capital. Innovations in financial markets that serve social enterprises include a variety of new instruments that will be outlined in this chapter. However, a mere transposition of financial tools and instruments from traditional financial markets or from developed to transitional economies will not suffice: the specificities of these economies must be taken into consideration. Common to all countries, however, is the recognition that new financial tools and instruments that combine financial and social returns require the investment of both private and public actors. Moreover, the experience in OECD countries has shown that enabling legal and institutional frameworks are the pillars upon which this activity can emerge and grow. In this evolving environment in which social enterprises have emerged, the traditional roles assigned to the public, private and so-called third sector are transforming. While we suggest that this represents a reconfiguration of state-civil society relations, we do not minimize the cultural challenge this poses within societies embedded in long established institutional contexts. Therefore, the impact on institutional change, for the time being, might best be characterized as incremental, iterative and culture specific. Relationships are still evolving, fluid and unstable contributing to an incoherent and complex socio-political landscape (Mendell, 2006).

In this chapter, we explore the principal streams of financing currently available for social enterprises, bearing in mind that this remains a contested term very much shaped by the institutional and cultural contexts of the countries within which these enterprises are emerging. What is common, however, and informs our chapter, is the growing presence and role of businesses committed both to wealth creation and to the public good. In many parts of the world, these social enterprises are collectively owned and take the form of cooperatives or not-for-profit organizations. Increasingly, the question of the legal form adopted by these enterprises has been subordinated to their social objectives, opening the way for private individual ownership of these enterprises. A great deal of literature is emerging that attempts to classify social enterprises along a continuum of ownership models (legal forms), sectors of activity and revenue-generating capacity, calling into question the role of government in facilitating the emergence and growth of these enterprises. In our own work, we welcome the growth of the social enterprise model and the recognition of the capacity of businesses to operate as social and economic actors. The current references to enterprises meeting triple bottom line objectives (economic, social and environmental) are only to be out numbered by the number of businesses successfully meeting these multiple goals. Many are even going one step further to include governance as an objective to be met, adding democratic decision making processes to social, economic and environmental objectives pursued.

We also recognize the need to cast a wide net despite the long commitment to collective ownership that characterizes these businesses that were, until very recently, associated with the social and solidarity economy. The wide net is necessary to capture the numerous initiatives that are embedded in community and respond to needs

unmet by the market or the state, but we do wish to distinguish our concept of social enterprise from the outset from those that represent a growing tendency to commercialize social services. The pressure to generate income in enterprises that are meeting primarily social needs is often felt in countries and/or regions where the disengagement of the state in social services is most present. In this case, social enterprises are a vehicle for the privatization of these services previously provided by the public sector. In vulnerable countries and regions, in both the north and in the south, this pressure can take pernicious forms if social enterprises and the entrepreneurship they rely upon is presented as a solution to deeply rooted and structural problems of poverty and social exclusion. As a solution to these difficult and complex problems without enabling public policy, it becomes a prescription for failure, for a good idea gone bad.

The present chapter is informed by these underpinning hypotheses, namely that the potential contribution of social enterprise to socio-economic growth and development must be part of a new policy framework that recognizes its capacity but also its critical needs for enabling policy tools. It does not call for the withdrawal of the state. Quite the contrary: it calls for a different engagement by the state that has potential to address these difficult issues. The same holds true for the investment market that is growing and responding to the financial needs of these enterprises. This, too, has to be situated within a policy framework so as to meet the objectives of financial viability and social return. On a positive note, we agree that social enterprises offer promise, especially as we face the urgent need to question the *new role* of the state, rather than its reduced role, too often an underlying objective in countries and regions embracing social enterprise and social entrepreneurs. For this type of business activity to take root and realize its objectives, there are several needs that must be met. In this chapter, we focus on finance, on the investment tools designed for social enterprises.

The investment market has transformed considerably in recent years. Alex Nicholls and Cathy Pharoah refer to a “landscape of social investment” to capture the growth of this new market (Nicholls and Pharoah, 2007). In this chapter we attempt to provide an overview of this activity that responds to the financial needs of social enterprises and increasingly to the growing public demand for new socially responsible investment opportunities. New actors, new financial instruments or products, new enabling legislation and public policy design are just a few of the components of this new financial market. New actors are emerging in the field and old actors are transforming their roles from donors to investors, as the growth of so-called venture philanthropy demonstrates. Governments are actively engaged in this emergent “landscape” with varying degrees; the institutional contexts determine the extent and the nature of this engagement. In the United States, for example, where direct government intervention is minimal, there is supporting legislation. In the United Kingdom, there is both an emergent policy environment and supporting and innovation legislation. In Canada, the Quebec experience is distinguished for its capacity to create a new multi-stakeholder investment market, for example, that includes the labour movement as a major investor in the social economy and active government participation. And so on. We are at a crossroads. This chapter contributes to the many important efforts to map this activity in different countries and regions internationally. Ultimately this activity is a response to the globalization of financial markets, often referred to as “financiarisation”, and the need to develop new and hybrid capital markets to combat exclusion and poverty globally. The belief that a new paradigm may be at the end of this shift is increasingly recognized.

While only imagination can limit the creation of new financial tools to provide capital for social enterprises, a thorough knowledge of the specific historical and socio-cultural contexts and an understanding of national and global financial systems are paramount to the launching of any new financial instrument. This chapter aims to contribute to this effort by exploring the sources of financing for social enterprises in advanced economies that currently exist and documenting the conditions that enabled their emergence. Through the examination of the

regulatory environment that facilitated innovation in the financing of social enterprises and the critical role played by civil society actors, we will look at the evolution of the sector, from the traditional providers of financial support (philanthropy, financial institutions, public financing) to the more recent financial innovations such as solidarity finance, patient capital, targeted or program related investment, socially responsible investment, venture philanthropy, to name a few. These new and often hybrid financial instruments generate *blended value* instead of an exclusive financial return. As this activity grows, unique tools for measuring their impact are emerging such as social accounting and social return on investment (SROI). This is critical not only to demonstrate the viability of social enterprises themselves, but also to confirm the growing commitment to contest the dominant paradigm by constructing appropriate tools with which to measure their activity and document their significant contribution to wealth creation.

Chapter 1

Social enterprise: A brief review

In recent years, the term “social enterprise” has become familiar to academic and policy audiences and increasingly to the general public as a new innovative business model that meets both social and economic objectives contributing to labour market integration, social inclusion and economic development. The interest in social enterprise follows a decade of growing recognition by local and national governments and international organizations of the role of the social economy, the non-profit sector, the solidarity economy or the third sector (Borzaga and Defourny, 2001; Dees, 1998). The last decade can be caricatured as a cacophony of terms, phrases, concepts that until recently meant many things to many people causing a great deal of confusion and misunderstanding. From a policy perspective, most countries faced a common policy impasse. The failure of neo-liberalism to address structural problems of poverty and social exclusion has led many governments to look closely to civil society initiatives as solutions to these difficulties. In many cases, these initiatives are rooted in their societies. We can provide numerous examples such as the social cooperatives in Italy, community economic development initiatives in the United States, solidarity-based economy initiatives in France, the social economy in Quebec and, of course, the numerous micro-credit organizations that had emerged throughout the world, just to name a few. These initiatives share their civil society origins but the nature and degree of institutionalization are very culture specific.

Today the reference to “social enterprise” is used to capture this variegated activity, often glossing over these specificities, thereby ignoring the role of enabling environments and presenting these enterprises instead as homogenous, autonomous business models with multiple, achievable goals. Whether they take the form of “new organizations” or “a new dynamic within the third sector” or as the seeds of an alternative economic development model calling for a new combination of resources – private and public, monetary and non-monetary, is not addressed (Borzaga and Defourny, 2001; Haugh, 2005; Defourny and Nyssens, 2008). Social enterprises are frequently analyzed from a micro-economic perspective as a response to either market or state failure or both. The term has crossed cultural and language boundaries without major problems. Having said so, these enterprises do not exist in a vacuum: indeed, the attention paid to entrepreneurship, mission-related economic activities or to the question of ownership varies considerably in different cultural and institutional contexts. While the potential of social enterprises for attaining blended objectives is recognized worldwide, a major difference in conceptual approaches lies in the weight given to economic versus social objectives within this type of private organization.

The interest in social enterprise has been accompanied, in the few last years, by the celebration of the ‘social entrepreneur’ through personal stories that speak of the inspiration, drive and business-like mind of individuals aiming to change the world. And so the focus on ‘social entrepreneurship’ initiatives has drawn the attention of public administrations, organized civil society and donors alike to the potential of these innovative individuals to respond to pervasive social problems so far unresolved by public policies and traditional socioeconomic actors. While the objective of this chapter is not to unpack these terms (‘social enterprise’, ‘social entrepreneur’, ‘social entrepreneurship’) or to define the boundaries that separate them, we note that they must be differentiated.¹ That these terms are used almost interchangeably in Anglo-Saxon contexts, has contributed to confusion particularly as regards the power, influence and potential of the actors involved and hence the expectations that follow.

¹ Abundant literature has appeared lately on these terms and their interaction on both sides of the Atlantic. We suggest Kerlin (2006), Nicholls (2006) and Defourny and Nyssens (2008) for a complementary discussion.

In this chapter, social enterprises are not seen merely as the institutionalization of a social entrepreneurship initiative, since the extent of what the latter encompasses continues to expand.² The conceptual framework selected for this chapter draws upon the work carried out by the Chantier de l'économie sociale and ARUC-ES3 in Quebec and by the EMES European Research Network in Europe.⁴ According to the latter, social enterprise is a private and autonomous organization providing goods or services with an explicit aim to benefit the community, owned or managed by a group of citizens in which the material interest of investors is subject to limits. Attention to a broad or distributed democratic governance structure and multi-stakeholder participation is also important. In Quebec, for example, where collective enterprise is synonymous with the social economy and with the now more frequent reference to social enterprise, the definition and emphasis moves beyond the "juridical-administrative dimension" related to the organizational form that social economy enterprises (SEEs) adopt, to insist upon the "value-added dimension" or macro dimension to demonstrate and highlight the unique contribution of SEEs to socio-economic development strategies, to constructing democratic economic alternatives and to the public good. More generally, social enterprises, as a specific sub-sector of SEEs, must be analyzed with both micro and macro-economic lenses and from organizational and normative perspectives.

The organizational arrangements and legal forms that social enterprises adopt vary greatly across OCDE countries. Current debate has widened the definition of social enterprise to include cooperatives, non-profit and community-based businesses that are integrated into social economy and community economic development strategies. These entrepreneurial organizations driven by socio-economic objectives (blended value, triple bottom line, for example) pursue clear objectives to benefit the community and combine social and economic goals in an original way (Nyssens, 2006). How they combine financial and non financial resources and the current landscape of financial sources available to social enterprises constitute the core of this chapter.

History matters. The importance of path dependency for institutional innovation

The need for alternative economic strategies is clear in numerous countries unable to solve deeply rooted problems of poverty and social inequality. It is not surprising that social enterprise has captured the attention of policy makers around the world given both the correspondence of this model with a predominant commitment to withdraw the state from the provision of public services, on the one hand, and with a growing tendency within countries to adopt more pragmatic approaches to socio-economic development. The social enterprise "model", so to speak, responds to both these impulses. And so, despite the great variability between countries in the north and between the north and the south, the support for this new business form that meets both public and private objectives is universal. As this model evolves, the nature of government participation will most likely reflect the historical role played by the state in different national contexts. What authors refer to as path dependency, will play a determining role in generating different organizational forms of social enterprise situated within different policy regimes (Crouch, 2001; Kay, 2005). From a combined social and economic perspective, the value added of social enterprises stems from their engagement with the production of goods and services, the work and social integration of disadvantaged population groups, territorial initiatives, etc. Through these activities social enterprises are contributing to a framework for sustainable livelihood and wellbeing, as demonstrated by numerous experiences in

² Notions such as corporate social responsibility have joined socially entrepreneurial initiatives (Nicholls, 2007; Austin et al. 2007).

³ ARUC-ES stands for "Alliance de recherche universités-communautés en économie sociale" or Community-University Research Alliance in the Social Economy.

⁴ The EMES European Research Network gathers 19 university research centers and individual researchers working together around the third sector and social enterprise. Active since 1996, it has published six major books to date that have been translated into French, Japanese, Korean, Portuguese, and Spanish, EMES also publishes a Working Papers series available to download online at www.emes.net.

OCDE countries (Borzaga and Tortia, 2007; Galera, 2008; Powell, 2007).⁵ As a result, social enterprises are contributing to social cohesion, to the accumulation of social capital, and to sustainable development at the local and national levels and, most significantly to poverty reduction (EMES, 2006; Aiken, 2007).

In a recent article on the place of social enterprise in emergent ethical markets, Alex Nicholls provides a useful classification of social enterprises as institutional, normative and transformative to distinguish their principal characteristics and objectives (Nicholls, 2007).⁶ We suggest, however, that while this may not be the intent, Nicholls' classification reinforces a focus on micro experiences drawing attention inward rather than outward as these enterprises challenge the dominant paradigm at all levels, micro (the enterprises) meso (new markets; intermediaries) and macro (socio-economic impact; policy implications). Instead, integrating these three objectives, while fully recognizing the characteristics and specificities of individual enterprises, becomes a powerful transformative tool to both describe the activity and the objectives of individual social enterprises and to situate them in a social change framework. While they certainly are giving rise to an ethical market for investors, social enterprises are also demonstrating their capacity to produce goods and services available to consumers at large.

The growing fascination with social enterprises expressed by numerous donors, policy-makers and social actors can paradoxically reduce their impact and long-term sustainability if they are suspended from their context. What was identified before as an advantage - the portability and transferability of this micro-economic organizational form - becomes an obstacle if attention focuses solely on its formal aspect and overlooks the larger vision driving social enterprise that calls for institutional innovation. Likewise, some of the attention that social enterprises currently receive overlooks the more complex issue of the viability of this economic activity and the need for supportive structures. The potential viability of these enterprises is simply assumed, thereby underestimating the difficulties faced by many social enterprises and the role of government in this emergent market.⁷ And as we have noted, social enterprises are particularly sensitive to modifications in public policy, especially regarding their eligibility for public subsidies (Bacchiaga and Borzaga, 2003).

Many authors are exploring these important questions. Some have suggested that social enterprises are part of a "new welfare mix" in which both governments and citizens cooperate in the co-design of new forms of social service provision (Ascoli and Ranci, 2002; Evers and Laville, 2004; Pestoff and Brandsen, 2006). This situation has resulted in a set of new practices (such as public procurement), institutional arrangements (such as work integration social enterprises) and actors (such as initiatives led by minority or disadvantaged groups). The sustainability of social enterprises to empower citizens economically, socially and culturally is complex, requiring human and financial resources and an enabling public policy environment that calls for policy innovation. It is noteworthy that in some Western European countries the shrinking of public and "voluntary" resources available to social enterprises coupled with their institutionalization process in a context of a free market has brought about a paradoxical situation: either social enterprises are "compartmentalized" within closed activity fields so as to continue receiving public funds or

⁵ At the end of the 1990s, more than 30 % of the population in the EU was a member of a social economy organization. Cooperative banks represent 17 % of the bank market and insurance mutuals and cooperatives hold around 30 % of the market. These organizations represent 8.5 millions FTE jobs or 7.7 % of the employed civil population (Laville et al., 2005).

⁶ These refer to social enterprises that (1) respond to market failure and/or "institutional void" by developing new products and services (2) contribute to the reconfiguration of markets to generate new or increased social value and (3) challenge institutional arrangements through political action (Nicholls, 2007).

⁷ Numerous articles are appearing in the media and specialized communication channels drawing attention to the risk of mission drift or the lack of a long-term, sustainable vision for social enterprises if emphasis is on the business dimension. Cf. *The Limits of Social Enterprise. A Field Study & Case Analysis* (Seedco Policy Center, June 2007, available at http://www.seedco.org/publications/publications/social_enterprise.pdf); *Social Enterprise in the Balance* (Pharoah, C., Scott, D, and Fisher, A., 2004, Glasgow: Charities Aid Foundation); "The distinctive challenge of educating social entrepreneurs: a postscript and rejoinder to the special issue on entrepreneurship education" (Tracey, P. and Phillips, N., 2007, *Academy of Management Learning and Education*, 6(2): 264-271); "An Enterprising Failure. Why a promising social franchise collapsed" (Paul Tracey and Jarvis, O., 2006, Case Study, Stanford Social Innovation Review).

they are left to their own devices in the market economy to mobilize the resources that they need (Nogales, 2007). Social enterprises are, in many ways, caught in a quagmire that often limits their access to private and public resources. While they are celebrated by the popular media and have attained great public visibility and while they are, for the most part, considered as new and hybrid small and medium-sized enterprises (SMEs), the nature of the mission, activity, and even the legal form of social enterprises still constrain their capacity to access resources. This is particularly true with respect to financing.

Chapter 2

Financing social enterprises

Current trends: An overview

The emergence and rapid growth of social enterprises has created a new financial market to respond to the need for capital to finance these enterprises. The nature of these enterprises has also called for financial innovation, for a customized financial sector that is not a mere replication or extension of existing financial products and instruments. Today's changing "social investment landscape", to borrow from Nicholls and Pharoah, is complex and reflects the recognition of social enterprise as a viable business model (Nicholls and Pharoah, 2007) that requires a diversity of financial products to correspond with the life-cycle of these enterprises (start-up or even pre-start up in some cases, consolidation and growth) and with their specific needs. This landscape also corresponds with a strategic reorientation that is perhaps best illustrated by the current shift from philanthropy to venture philanthropy, from gifts to investment, on the part of numerous large foundations and donors, for example. It is also illustrated by the development of new financial products designed to meet the specific and tailored needs of social enterprise that reflect a changing perception of social enterprises. Most significant is the rapid growth of ethical or socially responsible investment (SRI) and the potential this represents as a source of finance for social enterprises that now includes both screening and pro-active investment. Institutional funds are also entering this market. Several large pension funds in the United States, for example, have taken the lead, providing important lessons for cautious institutional fund managers elsewhere who continue to associate social enterprises with high risk investment beyond the legal boundaries set by fiduciary responsibility.

The need for financial innovation complements the traditional sources of funding that are tapped for social enterprises. These include government (at all levels) via direct involvement (grants, subsidies) or indirectly via enabling public policy making it easier to attract investment (tax incentives, public procurement, etc), philanthropy, financial institutions including conventional banks, credit unions, financial cooperatives and mutual societies as well as individual investors. A relatively well developed micro-credit (finance) market already exists with important demonstration effects for the expansion of alternative credit/investment into hybrid social enterprises. Much as the micro-credit market emerged to provide access to loan capital for marginalized groups and individuals "red-lined" by conventional financial institutions, the new investment market serving social enterprise is also innovative, calling for the invention of new investment products, broader investment criteria for existing financial actors and behavioral shifts among actors already engaged in supporting civil society initiatives that meet the objectives sought by these new social purpose businesses.⁸

⁸ Some traditional banks participate in these new business environments. There are several examples; we cite only a few such as the RBC in Canada that has established partnerships with social investors or the Charity Bank in the UK that has partnered with government. Credit unions, mutuals and cooperative banks have always played an important role in serving disadvantaged communities and are now poised to enter this new market. Notable examples include the Raiffeisen Bank in Germany (1864), the Mouvement Desjardins in Quebec (1900), the Groupe Cr dit Coop rative in France (1893), Banca Etica in Italy (1994), CREDAL in Belgium (1984) and the Fondation Macif in France (1983). These are but a few examples of better known large institutions; it is by no means an exhaustive list.

The role of government

The role of government in facilitating this type of investment activity has been important in several countries and has taken many forms, including legislation to establish intermediaries to reduce the perceived risk often associated with investing in these enterprises. The absence of standardized evaluation tools, coordinating mechanisms and adequate information contribute to this concern. Moreover, intermediaries increase the capacity to attract investment capital, to develop secondary markets and to facilitate the coordination of this emergent social investment market that remains highly fragmented at the moment. These are some briefly stated highlights or flashpoints of a new investment sector that is emerging to capitalize social enterprises. Table 1 below summarizes some examples of government support and illustrates them via selected early and more recent policy milestones in Belgium, Canada, the United Kingdom, and the United States.

Table 1 : Selected policy milestones in Belgium, Canada, the United Kingdom, and the United States

Country	Date	Policy
Belgium	2003	Universal Banking Service Act
Canada	1980s	Labour Sponsored Investment Funds (LSIFs) in Quebec (this required both provincial and federal legislation and fiscal measures).
	1990s	Active participation of the Government of Quebec in the development of solidarity finance and development capital
	2007	Formal launching of FIDUCIE in which the Governments of Quebec and Canada participated
United Kingdom	1832	Building Society Act
	1979	Credit Unions Act
	1994	Community Development Loan Funds and the Local Investment Fund
	2000	Recommendations of the Social Investment Task Force
	2002	Community Investment Tax Relief (CITR)
	2003	Futurebuilders England
	2004	Community Interest Companies (CICs)
United States	1976-77	Community Reinvestment Act
	1986	Low-Income Housing Tax Credit (LIHTC)
	1990s	Creation of Community Development Financial Institutions (CDFIs). They were officially recognized by the government agency, CDFI Fund (created in 1994)
	2000	New Markets Tax Credit Program (NMTC)

Innovative precursors in the financing of social enterprises

In mapping this activity, we must emphasize the legacy contributed by an already existing and established social finance or social investment sector not previously referred to as such but that has, until now, provided finance for cooperatives, community based initiatives and not-for-profit enterprises and organizations. Many of these have a long history. Many are active and powerful players on financial markets and compete with private banking and major financial players, for example. In countries such as Canada, the labor movement has also participated by establishing labor solidarity funds with diversified financial products to meet socio-economic objectives in underserved markets and, in many cases, by influencing economic development strategies through their investments in sectors and regions contributing to the maintenance and/or creation of jobs, economic revitalization as well as

the promotion of high performance sectors in the knowledge economy, for example (Mendell *et al.*, 2003). These established social finance and investment institutions are engaged in financial innovation either by developing new products themselves, or by entering into partnerships with civil society organizations, other financial players, and/or government. And finally, regional, national and international networks of these financial actors explore the expanded role of existing institutions and provide an important means to share information.

Despite this activity and the welcome supply of new financial resources, there are many challenges. This new financial market remains unstructured, segmented, incoherent and generates significant asymmetries, not the least of which is a supply driven agenda that does not always correspond with the needs of the enterprises seeking capital investment.⁹ The absence of a coordinating mechanism to bring these actors together in any systematic fashion results in information asymmetry as many researchers following this activity point out (Nicholls and Pharoah, 2007; Bibby, 2008, Commission on Unclaimed Assets, 2007). At other times, the challenge is greater still. The disequilibrium between the demand for and the supply of social investment or finance arises because available financial products do not always match the specific needs of social enterprises. For example, there is a great deal of loan capital available and too little equity or quasi-equity, resulting in disequilibria in both the loan and equity markets for social enterprise. The supply too often exceeds the demand for loan capital; in the case of equity, the reverse is true, with much unmet demand. This poses serious problems that can ultimately threaten the sustainability of these enterprises. Many social enterprises are heavily indebted and prevented from consolidating or expanding due to the unavailability of long term or patient investment capital.¹⁰ For the time being, designing such products remains a challenge, though innovative examples do exist. The volume of available capital is not the problem in many instances.

Social investment is fast keeping pace with innovation in conventional financial markets, creating hybrid products, new legal forms and financial innovation that reduces risk for investors and generates larger pools of capital. Social enterprises can access financing via numerous means: enterprise lending through public loan and grant programs; public refinancing and guarantees; mainstream banks; specialist intermediaries (including micro-credit and equity-type investments); specialist finance (targeting the social economy, sector specific finance and funding for SEEs; and integrated financial services at the local level (credit and loan cooperatives, community or local development funds, regional venture capital funds) to name a few (European Commission, 2001).

Context variability

In the United States, despite a minimal welfare state, social enterprises paradoxically have access to more targeted government programs, finance capital and innovative financial products. The United States has also introduced legislation that both requires existing financial institutions to invest in underserved markets and attracts private investment into social and/or community based enterprises. The Community Investment Act (CRA), passed in 1977, and the New Markets Tax Credit Program, launched as part of the Community Renewal Tax Relief Act of 2000, have created significant pools of capital; in the former case by way of enforcement, obliging banks to invest in

⁹ We have observed this in Quebec where there is a great deal of financial innovation that is welcome and has created, in fact, invented, new financial products to meet identified needs. Still, there are markets that remain underserved for a variety of reasons, most often associated with eligibility and/or nature of finance available lack of information, and so on (see Mendell and Bourque, forthcoming). The very useful work of Alex Nicholls on social investment and ethical markets confirms how representative these asymmetries are in the United Kingdom and in the numerous countries in which these financial innovations are emerging (Nicholls, 2007; Nicholls and Pharoah, 2007).

¹⁰ We are using patient capital, long term investment, quasi-equity to refer to the need for "equity-type" financial products to distinguish these from share capital "equity". This is fertile ground for financial innovation and has resulted in the establishment of interesting hybrid intermediaries such as Community Interest Companies in the U.K. and the Fiducie du Chantier de l'économie sociale in Quebec as two examples.

community initiatives, in the latter, by creating tax incentives for private investors (New Markets Tax Credit Coalition, 2007).¹¹ As well, intermediaries in the United States have played a pivotal role in successfully delivering investment into communities. The large network of community development financial institutions (CDFIs), for example, has performed a vital role in reducing the information and coordination problems we addressed earlier.

The United Kingdom has, in many ways, surpassed the commitment of the United States to social enterprise and community based initiatives in recent years. The Social Enterprise Unit, established in 2001, that is now integrated into the Office of the Third Sector within Cabinet and the numerous innovative programs and a fiscal framework promoting social investment, are now examples for other countries. In this chapter, we only note the Community Interest Company (CIC), an innovative new legal form established in 2004 that addresses what we may refer to as the grey zones of the social investment market, namely the “how” and “where” to invest that has generated confusion for prospective investors. The CIC is a hybrid intermediary that protects investors, both private and public, and assures the flow of investment into social enterprises. This is a fascinating illustration of innovation in financial and commercial markets. Established to serve the public interest, CICs are obliged by law to retain their investments through an asset lock. But to attract investors, they are permitted to issue shares and pay dividends (Nicholls and Pharaoh, 2008; Hebb *et al.*, 2006). The commitment to this activity in the United Kingdom is best illustrated through the transfer of responsibility to the Cabinet Office with an assigned minister. This, in our view, should serve as an important example of the necessity to move out of a silo approach to social enterprises (previously located in Trade and Industry) to a horizontal space that reflects the inter-sectoral nature of the issues addressed - social, economic and environmental - by these enterprises. This is a recurring theme in this canvas of experiences in different countries confirming the need for innovation in policy, in legislation and in institutional structures to support this activity within and outside the boundaries of government.

In Canada, the federal and provincial governments have been the principal source of capital for social economy enterprises through subsidies and grants, though these have been reduced or targeted to project and program delivery. Credit unions across the country have always played an important role in supporting what we may call the “old” social economy (cooperatives, principally); however, they are now engaging with social enterprises, that include cooperative, non-profit and privately owned social purpose businesses. In Quebec, the commitment to collective ownership is very strong and social enterprise is synonymous with the social economy. This is not a rigid adherence to a particular legal form but rather to the commitment to democratic governance. We will return to this question later as it is an important issue that is being addressed among actors committed to democratic governance but who also recognize that this can be achieved through multi-stakeholder governance as well, for example (Hebb *et al.*, 2006; Chertok *et al.*, 2008).

It is beyond the scope of this chapter to explore the large range of innovative models emerging throughout Europe. Instead, we are highlighting selected country innovations in the policy domain and/or within the social investment community that are keystones to consolidate and coordinate this rapidly growing but highly segmented investment market internationally. Complementary to the need for enabling policies are intermediaries both to reduce risk and to provide a structure to embed this activity. For social investment and/or finance actors, the availability of networks has also been important, especially as this sector becomes more complex and variegated. Several networks exist, both formal and informal. In our view, formal networks or federations are increasingly important for several reasons, including the establishment of a coherent alternative financial market. The creation of the *Fédération Européenne des Banques Ethiques et Alternatives* (FEBEA) in 2001, for example, has brought together numerous

¹¹ The NMTC program expects to generate US\$19.5 billion in investments by 2008 (New Markets Tax Credit Coalition, 2007).

financial institutions that finance the social economy and social enterprises across Europe. There are now several networks of micro-finance institutions, such as the Opportunity Finance Network in the United States, the European Micro Finance Network or the *Réseau québécois de crédit communautaire* in Quebec. A challenge identified by many micro-credit actors is the need to scale up their activities. These networks have been key to the innovative creation of secondary markets for micro-credit, for example, increasing the capital available for the numerous micro-credit institutions within these networks (Mendell *et al.*, 2003; Nicholls and Pharaoh, 2007). Created in 1989, the International Association of Investors in the Social Economy (INAISE) has played an important role as an informal international network for many years that provides an international space for dialogue and exchange, sharing of information, technical support, etc., among numerous actors internationally. In Quebec, solidarity finance institutions have expressed the desire to create a formal network for many of the reasons outlined above, but principally to benefit from the economies of scale such an organization would generate as this would reduce the duplication of many activities that each institution undertakes by creating common resources where possible. Moreover, the presence of such a federation would also generate important political capital, allowing a single voice to press for enabling policies.

An evolving financial landscape for social enterprises

Innovative trends for financing social enterprises

In addition to the traditional sources of finance reviewed in the prior section, a vast array of strategies and instruments for financing social enterprises has emerged in the past decade as well as a new vocabulary to describe these activities. Social investment or finance, solidarity investment or finance, ethical investment, socially responsible investment, community based investment, program related investment (PRI), economically targeted investment (ETI), mission investing (MI) or venture philanthropy are some of the concepts and terms to describe these activities. Added to this are terms such as social capital markets, for example, to describe the allocative mechanism through which these activities flow. While, on the whole, these terms point to a new phenomenon, namely, a new form of financial investment, they create confusion. Some of these activities are the evolution of more traditional forms of financing social enterprises, as for instance, the new venture philanthropy that represents a shift in orientation by foundations and donors from gifts to providing a hybrid form of venture capital that integrates social and economic return. Others, such as patient capital or quasi-equity referring to new long term investment products or the CIC, a new organizational and juridical form created in the United Kingdom to meet the investment needs of social enterprises offering secure investment opportunities while preserving the public good served by social enterprises through the enforcement of an asset lock; or the recent launching of collateralized loan obligations (CLO) by micro-finance intermediaries to access large pools of capital, or the development of an ethical trading market by issuing shares through a matched bargain or swap process, can all be characterized as *social innovations*.¹²

The nature of available investment instruments and products, from loans to quasi-equity and equity and the numerous actors involved has produced a complex landscape. What is ultimately a new form of financing is, in fact, a mixture of innovation and repackaging or shifting of existing practices, as venture philanthropy most clearly demonstrates but is present in other forms of activity as well. Moreover, as we also noted earlier, numerous new concepts and terms contribute to this complexity as they are not always clear and do not always speak to a particular financial tool but rather describe the behavior of individuals and/or organizations and institutions engaged in this activity.¹³ In many cases, terms such as “conscious”, (Triodos Bank, 2006) “ethical” and/or “socially responsible” investment or “affirmative financing” (Borzaga, 2005; Hebb *et al.*, 2006) are simply synonyms for proactive investment choices although they can also give rise to segmented markets.

Until very recently, ethical investment referred exclusively to negative screening, to the rejection of enterprises producing goods harmful to the environment or in violation of human rights. This continues to guide the investment decisions of individuals seeking a financial return while maintaining a concern for social, environmental and ethical issues. The Socially Responsible Investment label that captures ethical investment opportunities is now widespread and numerous funds screen stock-market portfolios or work with companies to improve their corporate practices (Triodos Bank, 2006).

¹² Geneva based micro-finance investment intermediary, BlueOrchard Finance issued its first stand-alone CLO in 2006 creating a new asset class (Davidson, 2007); Triodos Bank lists shares on their own Triodos ETHEX market through a matched bargain market managed by Brewin Dolphin Securities Limited. This is not a recognized investment exchange and yet each issue has been fully or even oversubscribed. www.triodos.co.uk

¹³ Cf. Kinder (2005: 23-24) for an interesting discussion on nomenclature.

No longer on the economic margins, SRI currently represents 13% of savings in the United State and 7% in the United Kingdom that is managed in a responsible way. Moreover, SRI is present at various levels: a majority of these investments are made at the local level (via micro-finance institutions); at national or regional levels (via financial organizations and banks); and at the international level (via guarantee funds or solidarity investment companies). In addition to the plethora of socially responsible financial products, they also perform better than traditional ones, especially in the long run. Borzaga (2005) concludes that this reflects the positive reputation of socially responsible firms, the lower level of internal and external social conflicts, and the prevailing climate of trust. Although at the moment socially responsible behavior is primarily an individual decision, it is influencing the increased adoption of socially responsible behaviour by corporations and industries sensitive to the growing importance of social responsibility for customers and investors (Borzaga, 2005).

Other terms such as “sustainable”, “responsible” and “social banking” are now part of the vocabulary and are often overused, generating confusion and uncertainty among those interested in screening their investment activity. Today, references to ethical investment include both screening/vetting and pro-active investment adding to this confusion. That said, proactive ethical investment, has raised consumers’ awareness of how their money can be placed in sectors of activity that contribute to the well-being of society. Social enterprises have the potential to access this form of investment by individuals, companies and institutional investors.

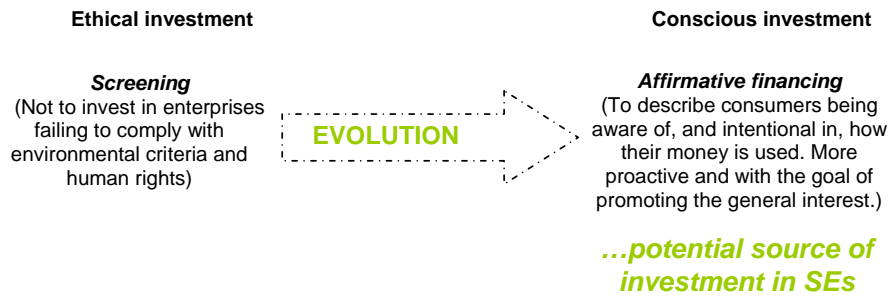
Table 2 : Socially Responsible Financing

	Form	Activity	Actors
Responsible indirect investing ("placement responsable" in French)	Portfolio screening (exclusionary or inclusive)	Investments in financial markets using exclusion or inclusion filters based on environmental, social and governance (ESG) criteria.	Ethical funds, foundations
	Shareholder engagement (or activism)	Shareholders that utilize their role to influence the practices of enterprises.	Pension funds, awareness raising organizations, some ethical funds
Responsible investing (pro-active/direct)	Development capital	Risk capital with socioeconomic goals (i.e. job creation, local and regional development, and environmental).	Investment tools developed by associational actors (labour solidarity funds, cooperatives and credit unions)
	Solidarity-based finance (social finance)	Financing of community economic development and social enterprises.	Micro-credit, financial cooperatives, hybrid innovative financial funds

Source: Adapted from Chantier de l'économie sociale (2006) and Mendell and Bourque (forthcoming).

The above typology is useful to illustrate how SRI has moved from negative screening to pro-active investment. We include this because it also distinguishes between portfolio and direct investment behaviour which lies behind the term “socially responsible finance” used in Quebec to differentiate between these. More generally, the evolution of the SRI market is often presented as a shift from “ethical” investment that describes screening to “conscious investment” to capture direct, pro-active or affirmative financing.

Figure 1: Evolution of the social investment market



Five areas of innovation for finance provision for social enterprises

We cannot underestimate the power that language and vocabulary has had in this evolving market for social finance. As many terms associated with this new form of investment activity speak increasingly to promoting sustainable livelihoods, it is also capturing the attention of the media and the general public. Indeed, the recent Nobel prize awarded to Mohamed Yunus has contributed to this, increasing the public awareness of the role of micro-credit, in particular. Also, individual savers are able to respond to humanitarian concerns through new savings vehicles created by numerous financial institutions. This dovetails with the growing desire to consume responsibly. Labelling has become very important as a means to identify both goods and savings opportunities that meet these desires on the part of a growing public.

Financing social enterprises fits into this new era of social consciousness that empowers individuals to express their choices through their consumption and savings behavior. It empowers individuals to invest their retirement funds in secure ethical instruments and it enables financial institutions (emerging and existing) and intermediaries (emerging and existing) to channel investment capital to social enterprises. The map is evolving; the number of actors is numerous; analysts following these trends are generating a glossary to distinguish these new instruments and products (Chantier de l'économie sociale, 2006; Nicholls, 2007; Commission on Unclaimed Assets, 2007). From among the panoply of new products and strategies we have described that include pro-active investment choices in all sectors of economic activity, we have identified at least five new products that are potential sources of financing social enterprises: solidarity finance; venture philanthropy; institutional investment; individual investment; quasi-equity and equity instruments (mainly patient capital and social capital markets). And of course, there are the conventional financial institutions, the increasing number of banks willing to serve these enterprises as well as government, through grants, guarantees or innovative partnerships with social finance actors and/or through public policy tools.

Solidarity finance ("*finance solidaire*" in French) is defined as the "art of managing money in its different forms - savings, investment, credit, account management - in the public interest, thereby encouraging individuals through their actions as savers and investors, to assist others".¹⁴ The formal solidarity finance movement originated in Europe, although conceptions of "solidarity" vary considerably across national contexts and cultures. For instance, while the notions of solidarity ("*solidaire*") and ethics ("*éthique*") are distinct, in countries like Spain and Italy,

¹⁴ Cf. FINEUROSOL, the network of solidarity finance organizations in Europe launched in 2005 and supported by the European Commission (<http://www.fineurosol.org>). We have slightly modified the translation of this statement into English by FINEUROSOL.

ethics or ethical best capture this activity ("*ética*" and "*etica*" respectively), since solidarity implies charity. In Quebec, solidarity finance refers investment activities in the social economy (from micro-credit to patient capital), thus referring exclusively to investment in collective enterprise. To further complicate the landscape, in Quebec, development capital is distinguished from traditional risk or venture capital to refer to investment with socio-economic objectives, but not restricted to the social economy.

The distinction between private and collective ownership remains important as we have already noted. In Quebec, this has generated an additional category to differentiate "alternative" financial/investment activity in private and collectively owned enterprise more generally subsumed under the umbrella of social investing in most countries (Mendell *et al.*, 2003). Countries such as Belgium and France have well established mechanisms of solidarity finance, while others are only introducing this activity and have yet to settle on a definition.¹⁵

There are two main types of solidarity financial actors: solidarity financial institutions or solidarity-friendly financial institutions. While they can be distinguished by the type of projects they support, they share some key characteristics: on the supply side, the central role of citizens and the availability of financial tools similar to mainstream financing; on the demand side, the variety of projects supported (social and work integration and job creation; innovative solidarity activities (e.g. fair trade); social housing; North-South cooperation; solidarity financial institutions partnerships, etc.).

Until recently, solidarity finance, at least in those countries in which this activity is not new, has primarily been expressed through savings choices by individuals. However, the growing field of solidarity and/or ethical finance, also represents an important supply of capital for social enterprises and also meets the criteria sought by socially responsible investors (whether through placements or through pro-active investments), opening this activity to a broader social investment market.

Case study 1 - The Alternative Financing Network

The Alternative Financing Network (Réseau de Financement Alternatif or RAF), founded in 1987, brings together non-profit associations seeking to promote ethical and solidarity-based finance. It has 70 member associations involved in the social economy, environmental issues, efforts to combat exclusion, human rights, education and training, etc. The network carries out research and conducts campaigns aimed at alerting savers and investors, political authorities, financial institutions, the voluntary sector and academic circles to ethical and solidarity issues in money-related matters.

The network also develops both ethical and solidarity-based financial products: savings accounts, unit trusts and life insurance policies. Solidarity products include shared-return products, with a solidarity commission paid back to the network's member associations. It invested more than 240 € million in 2003.

The RFA is in contact with local authorities that invest in ethical funds. It is currently conducting a survey of local authorities in order to ascertain their expectations of socially responsible investment, prior to launching a massive awareness-raising campaign targeting such authorities, inspired by the solidarity weeks organized by Finansol in France. The RFA has very actively lobbied the Belgian government to move towards a universal banking service, with positive results. Other campaigns have also been conducted. In 2004, the campaign against bank investments in the armament industry led to

¹⁵ At the practical level, there are two mechanisms of solidarity finance: savings capital whereby a percentage of savings capital is invested into organizations or projects having a social, cultural or environmental added value, and/or savings income whereby solidarity savers voluntarily give (share) all or any part of profits generated by savings to organizations or projects with a social, cultural or environmental added value. cf. <http://www.finansol.org> and <http://www.fineurosol.org>

the enactment of a law prohibiting unit trusts from investing in anti-personnel mines. A 2004 private bill seeks to ensure that environmental aspects are taken into consideration in companies' annual accounts and management reports. Another private bill calls for the granting of official aid invested abroad to be subject to social and environmental responsibility criteria. Yet another private bill demands tax concessions for investments promoting sustainable development.

To learn more visit the Alternative Financing Network's website at <http://www.rfa.be>

Philanthropy has traditionally been a major source of funding for socially oriented activities and organizations. The interest in social enterprise, as we noted earlier, is best illustrated by the rapidly growing **venture philanthropy** sector and its transformation of the venture capital model into a social investment strategy to include blended returns (Howard and Giddens, 2004; Grenier, 2006; John, 2006). Social venture philanthropists (SVP) treat their grants as investments. Through the implementation of new investment strategies that combine the provision of finance, business advice and monitoring, social venture philanthropists are creating new methods to redirect what used to be considered as maximum-risk, no-return charitable funds. They also note that this shift in financing social enterprises from gifts to investments represents a new means to recapitalize foundations. Because the culture of philanthropy is embedded in these foundations, the question of risk is not dominant resulting in different and often contradictory calculations of risk (Nicholls and Pharoah, 2007). Whether supporting program-related investment (PRI), mission-related investment (MRI) or economically targeted investment (ETI), numerous instruments for supporting social enterprises have been developed by foundations with different levels of performance and return on investment requirements.¹⁶

Several large foundations pioneered mission investing with PRI in the 1960s and 70s. It was not until the 1990s that other smaller foundations followed. Today, most foundations engage in this type of activity. In selecting investment opportunities, venture philanthropists prioritize the innovative entrepreneurial aspect of the initiatives they will support, further complicating the capacity to evaluate risk and return. Venture philanthropy raises important questions including the reduced donations available and, in some cases, pressure on enterprises providing social services generally supported by foundations and philanthropic organizations to commercialize their activities to access this investment capital. Like the many players in the growing social investment market, venture philanthropists have contributed to the work on evaluation and performance measurement by developing new tools or adapting existing ones to systematically calculate the blended returns they expect.

A recent comprehensive study by FSG Social Impact Advisors on mission investing in the United States, surveyed 92 US foundations that have made \$2.3 billion in mission investments over a period of 40 years. The study raises important challenges common to other social finance actors, in particular, the necessity to establish intermediaries to assist in "deal matching" between investors and potential investees. It also raises the critical need for enabling fiscal policy that has been key to the capacity of foundations to invest at below market rates. These investments qualify as program-related and count as part of the annual payout requirement of foundations (Cooch *et*

¹⁶ While common understandings of these terms do not exist, the Foundation Center (<http://www.foundationcenter.org>), defines program-related investments (PRIs) as investments made by foundations to support charitable activities that involve the potential return of capital within an established time frame. PRIs include financing methods commonly associated with banks or other private investors, such as loans, loan guarantees, linked deposits, and even equity investments in charitable organizations or in commercial ventures for charitable purposes. Mission-related investing (MRI) refers to the investments made by foundations to directly advance their core missions, in coordination with their grant-making through instruments that include deposits, fixed-income securities, senior and subordinated loans, preferred and common stock, and private equity. As for economically targeted investing (ETI), it allows pension and other collective funds to invest in economic revitalization (urban and regional regeneration) and social projects (housing development, for example) while assuring solid returns on investment.

al., 2007).¹⁷ Foundations such as Calvert in the US, have developed Community Investment Notes to increase the liquidity available for community based initiatives such as affordable housing, micro-credit, small business development, community facilities and social innovations. Investments are pooled in a managed portfolio of low-cost loans to more than 200 leading non-profit organizations and social enterprises internationally that are engaged in alleviating poverty around the world. This is one of many examples we have selected to demonstrate the capacity to *innovate*. Risk reduction is key to this process, hence the attraction of a product backed by a large foundation. Calvert has introduced its own SRoI so that investors can track the impact of their investments.¹⁸

The need to capitalize social enterprises has not been met despite this array of new investment tools or the openness of existing tools to social investment. The largest potential source of capital is from **institutional investors** such as pension or mutual funds, insurance companies, or traditional banks, that manage large portfolios of capital. This pool of institutional investors remains largely untapped. The availability of institutional funds is constrained by legal forms and by strict adherence to fiduciary responsibility, limiting this form of investment considered high risk. The problem of image and perception of social enterprises is especially true among institutional investors. That said, there are important precedents to draw upon such as several large institutional funds in the United States (CalPERS Foundation¹⁹, TIAA-CREF), France (Caisses de dépôt et consignation) and Québec (*Caisse de depot*) that include non-financial social criteria in their investment decisions and the obligation by several pension funds, to demonstrate their participation in SRI. Still, operationalizing this commitment remains a challenge notwithstanding the numerous structured, credible and mainstreamed SRI opportunities available, strongly suggesting that while the growing SRI movement is attractive, it is still not well understood.

Many institutional funds already invest in economically targeted investments (ETI), in emerging domestic markets or underserved capital markets (Hebb *et al.*, 2006). These examples are extremely important to dispel the view that such investment is a breach of their fiduciary responsibility. A survey in 2006 by the Teachers Insurance and Annuity Association, College Retirement Equities Fund (TIAA-CREF), one of the largest financial services companies in the United States serving institutional and individual clients in the educational, medical and cultural sectors, revealed the growing interest of subscribers in knowing about the environmental and social impacts of their investments, calling for more information on how their personal values could be reflected in their investment portfolios without compromising their economic returns. Investing in social enterprise would certainly meet the “collateral benefits” that pension fund ETI must demonstrate.²⁰ The findings of this survey and the financial capacity of institutional funds are indicators of the capacity to access this source for social enterprise investment. The work to be done includes providing information, careful “packaging” and creating the means to broker these investments.²¹

¹⁷ The US Department of the Treasury's Internal Revenue Service allows for a special tax exempt status to foundations for their program-related investments. As the IRS explains, “the investments, to be program related, must significantly further the foundation's exempt activities. They must be investments that would not have been made except for their relationship to the exempt purposes” (cf. <http://www.irs.gov>).

¹⁸ Cf. <http://www.calvertfoundation.org>

¹⁹ CalPERS' goal is to invest 2% of its portfolio (\$200 billion) in California's underserved capital market (Hebb *et al.*, 2006, p. 29).

²⁰ TIAA-CREF currently has more than \$435 billion in assets.

²¹ Cf. <http://www.tiaa-cref.org>. An interesting American example is AltruShare Securities, a “unique social enterprise in financial services” that combines business skills with community investment initiatives. AltruShare is the first institutional brokerage firm to specialize in community investment and the first Community Investment Enterprise in the United States. It is a for-profit business that generates income for underserved communities. It is an interesting example of institutional innovation combining for-profit with non-profit activity. By brokering these investments, it fulfills an important coordinating role (cf. <http://www.altrushare.com>)

In Canada, the province of Manitoba has passed legislation to include non-financial criteria in investment decisions taken by institutional funds, opening the possibility for institutional funds to invest in social enterprises.²² The ability to evaluate the performance of these enterprises remains a barrier despite the numerous new indicators and evaluation tools now available. The most reliable sources of information are the numerous stories of the impact of social enterprises on their local communities.

Intermediaries and new financial products are critical to permit institutional investors to play a more active role in capitalizing social enterprises. This is less complicated than it appears, as experience in some countries shows. Once again, the need for financial intermediaries is raised to enable these large players to engage with social enterprises.²³ Community partners are also critical to the successful outcome of these investments. Experience increasingly confirms the necessity for partnerships between community based organizations and financial actors. For large institutional funds to participate, the importance of these two forms of mediation cannot be over-emphasized.

Individual investors are also a source of finance although their presence is uneven across countries. Two groups of individuals can be included in this category. The first one refers mostly to socially motivated *high-net-worth investors*²⁴ (HNWI) whose money is managed by powerful financial advisors through expanded portfolios to cater to this new investment market. *Angel investors* in the United States are willing to invest in social enterprises. They are part of the Investors Circle (IC) whose mission is to provide long term capital for sustainable economic development. Since 1992, they have invested \$100 million in 163 businesses including community development enterprises and women and minority owned businesses. A 2002 study by Harvard Business School and McKinsey & Company found that companies in which IC invested generated competitive returns (Investors Circle, 2006 in Hebb *et al.*, 2006: 28). Moreover, organizations such as Social Venture Partners International, Social Ventures Network and Co-op America back angel investors and philanthropic organizations that wish to invest directly in social enterprises (ibid, p. 29). They are now joined by individual, small-scale investors. By constructing information networks, these “citizen investors” belong to an accountability circle that allows them to bypass corporate management or institutional investors for information regarding portfolio investment opportunities (Davis *et al.*, 2006).

²² In 2005, the United Nations Environment Programme Finance Initiative (UNEP FI) commissioned a study by the international law firm Freshfields Bruckhaus Deringer to explore whether social and governance issues are permitted or restricted by existing laws and regulations governing institutional funds. This study confirmed the prevalence of a perception problem, this time associated with the laws governing these funds and that, in fact, there are several examples in different parts of the world where these funds are required to comply with both specific laws and general duties assigned to these funds. In the United States they found that the focus is on returns realized across a well-managed portfolio as part of a rational investment strategy allowing for a great deal of flexibility.

²³ A recent example in Canada involving the Public Service Alliance of Canada, a very large public sector union and Alterna Savings, a credit union, will generate capital to invest in low-cost housing. This is an important example of how a deal was brokered between a large pension fund and an existing financial institution (credit union) to generate investment capital. And it was simple since it only required the sale of a fixed income security, a Guaranteed Income Certificate, backed by the credit union. The pension fund now owns a security; the financial institution acted as an intermediary in this transaction. But that is not the end of the story. As this is a new market for social housing, yet another intermediary that represents the community is called for. In Quebec, for example, this need has been met by establishing intermediaries at the local level. The Chantier de l'économie sociale has acted as a vital inter-sectoral intermediary for social economy enterprises greatly increasing the capacity to raise capital. The absence of intermediaries raises the transactions costs of these investments and is a deterrent in engaging in this activity.

²⁴ Individuals with minimum asset portfolios of \$5 to \$10 million.

Quasi-equity finance is a hybrid debt type of finance that nevertheless shares some characteristics with equity capital in that it meets the needs of social enterprises for long-term investment capital. Because social enterprises that are collectively owned do not permit the sale of shares or more generally because shares of social enterprises are not traded on capital markets, quasi-equity allows for capital to remain in the enterprise without conferring ownership. Quasi-equity takes many forms including repayable grants, subordinated and unsecured debt (Commission on Unclaimed Assets, 2007).²⁵

The availability of quasi-equity allows social enterprises to finance growth and to invest in capital equipment and real estate (passive assets) that short term debt does not permit. This is critical to developing the capacity and sustainability of these enterprises. As we stated earlier, the many debt instruments available at the moment do not respond to the urgent need for long-term capital investment essential for the consolidation and growth of these enterprises. The specific conditions that this form of investment takes depends on the agreement reached between investors and borrowers (for instance, Futurebuilders England recently launched a finance option whereby the investment is repaid on the basis of a percentage of the social enterprises' annual gross revenue that has been previously negotiated).

An ambitious initiative to create quasi-equity or patient capital has been spearheaded by the *Chantier de l'Économie sociale* in Quebec (see case study 2 below).²⁶ Not only has it responded to the need to capitalize social economy enterprises with an innovative financial product (a form of security or debenture), it has done so by building the infrastructure necessary to embed this type of investment activity. The call for intermediaries in the segmented market that thus far characterizes the growing social investment sector was understood in Quebec. In addition to seeking investor/partners, it immediately established a multi-stakeholder intermediary including all partners in this initiative - government (federal and provincial), the labour movement and the social economy. Each of these actors participates as investors and as trustees of this intermediary. Furthermore, the initiative was undertaken by a network of social economy networks, bringing the potential investees to the table. The Chantier, this network of networks, is also a trustee in this intermediary, effectively coordinating the supply and demand for this type of investment thereby removing important obstacles and asymmetries identified by the numerous participants in this evolving new financial sector internationally.

The need to pool risk was recognized from the outset, thus the practical and immediate need for an intermediary. Initial support by the federal government leveraged participation by the two large labour solidarity funds in Quebec as well as the provincial government. The presence of government at the table is key to this initiative, greatly reducing information barriers and the transactions costs for both the social actors and government. This is an important example of how financial and social innovation requires institutional change. In this case, a multi-stakeholder deliberative organizational model provides opportunities for government to collaborate in the co-design of a new institutional architecture and the co-construction of new policies to address social and economic objectives. Unlike numerous examples of bricolage, this is the outcome of a well conceived integrated plan of action to assure deal flow and rates of return for investors and access to much needed long term capital for social economy enterprises. Many of the obstacles that limit the development of this market were addressed in the design of this intermediary. Today, the FIDUCIE is engaged in the development of a secondary market. A coordinated strategy has avoided the segmentation which so characterizes this sector, however large the potential capital pool is within individual countries and internationally.

²⁵ Cf. FIDUCIE of the Chantier de l'économie sociale at <http://fiducieduchantier.qc.ca/?lang=eng>

²⁶ For other alternative finance options based on the quasi-equity principle in the UK, see Nicholls, 2007.

Case study 2 - FIDUCIE by the *Chantier de l'économie sociale*

On February 2007, the FIDUCIE of the *Chantier de l'économie sociale* began its activity in the financing of social economy enterprises (not only social enterprises). For several years, social economy enterprise directors expressed the need for financial products other than traditional grants and loans, and at the same time discussed ways to retain long-term capital in their businesses. They wanted new products that would take their social mission into account. As for private and institutional investors, many of them were reticent about engaging in the social economy. This, despite convincing evidence of lower write-off rates in social economy enterprises and a business longevity twice that of traditional private businesses. The FIDUCIE is a response to these multiple needs. It is positioned as an intermediary between the financial market and social economy enterprises. Its aim is the mutualization of risks, which translates into lower financing costs for enterprises. Because it offers a diversified portfolio to investors, they do not need to analyze and evaluate the potential return and the risk of each enterprise. The FIDUCIE works with an impressive network of stakeholders, allowing it to evaluate projects in a realistic and careful manner. The FIDUCIE offers a product to complement those available on the market already: "patient" capital, in other words, loans with a 15-year capital repayment moratorium. These investments are offered in two forms: operations patient capital, to finance costs related to working capital, marketing of new products, and the purchase of equipment; and real estate patient capital, to finance costs that are directly linked to the acquisition, construction, or renovation of real estate assets.

The FIDUCIE's initial supply of capital came from Economic Development Canada and a number of investors including the FTQ's *Fonds de solidarité*, the Québec government and FONDACTION, *Fonds de développement de la CSN pour la coopération et l'emploi*. With this initial fund of \$52.8 million, the FIDUCIE can now support the development of social economy enterprises.

In 2007-2008, CAN\$2.9 million will be invested in ten social economy enterprises that operate in different sectors and regions across Québec. These investments will generate a total investment of CAN\$16.3 million, enabling the creation and consolidation of over 342 jobs.

For more information visit <http://fiducieduchantier.qc.ca>

Some important lessons learned from the FIDUCIE include the meticulous preparation process from conception to implementation that required several years; the multi-stakeholder approach to design such a specific and complex financial tool and most important, the consensus-building, collective decision-making, and determined leadership that were key to this initiative.

Ethical or social capital markets are emerging to increase capital pools to finance social enterprises. The development of a social stock market is not a new idea. What is clearly an alternative and potentially powerful financial market that can compete with mainstream capital markets requires appropriate mechanisms to raise both the awareness and the confidence of potential investors. Despite the numerous criticisms and examples of failed attempts to launch such a system, the idea of a social finance exchange, for example, continues to interest many social investors. As illustrated by Hartzell (2007) and Nicholls (2007), the market for equity share offerings for social enterprises in the United Kingdom exists, although the number of these organizations that trade is very limited (there are seven social enterprises currently engaged in equity trading in the United Kingdom, although none of them participate in traditional stock markets). An alternative full-blown social stock market does not presently exist, although the ETHEX (Ethical Exchange) initiative backed by Triodos Bank is an important step in developing this market. Sometimes called EPOs (ethical public offerings) or APOs (alternative public offerings) now make this possible. Several social enterprises followed the lead of Traidcraft in the U.K. when it launched its first ethical share

offering in 1984. Buyers and sellers were brought together by Triodos Bank on a “matched bargain” basis structured by a securities firm. Since that time, the ETHEX initiative has allowed for several share offers.²⁷

The question of ownership is frequently raised and in certain regions, such as Quebec, the commitment to collective ownership remains firm. In one example in the United Kingdom, the decision to launch an APO also meant the restructuring of the enterprise from a non-profit to a multi-stakeholder structure, allowing for private investment.²⁸ This is the subject for debate among actors in different cultural and institutional settings. Among the obstacles currently cited that hamper the development of a financial market for social enterprises is the lack of performance measurement standardized methods. Notwithstanding the larger debate about what the real “return” of social enterprises is, there are new indexes such as the Dow Jones Sustainability Indexes (DJSI) or the FTSE4Good Index Series.²⁹

In 2006, ethical investments reached almost \$3 trillion in the United States and £11.6 billion in the United Kingdom. This sector of financial investment is outperforming mainstream financial markets (Nicholls, 2007). Moreover, social enterprises have contributed significantly to the development of this activity. However, the absence of a coordinating mechanism limits the development of a coherent market. Alex Nicholls once again raises the critical need for an intermediary space (ibid). The example of carbon exchanges and an incipient social stock market through the increasing number of APOs, alternative indexes, and matched bargain swaps developed by Triodos, are examples of how markets can be created (Nicholls and Pharaoh, 2008). Increasingly, the need for information, standardization and coordination is critical to coordinate what is still a highly segmented market replete with uncertainty.

²⁷ Triodos proposes the initial price and then tries to match registered sellers with any registered buyers.

²⁸ While such an enterprise is now “private” in legal terms, this restructuring reinforces the hybrid nature of social enterprises whose clear mandate is to achieve a blended return. A stakeholder structure falls under a limited legal form that unfortunately cannot capture or accommodate an organizational innovation. Just as social cooperatives were created in Italy and social purpose businesses in Belgium and in Finland that do not question ownership, to name but two examples, we have a new challenge. The solidarity cooperative, a Quebec adaptation of the Italian social cooperative now exists, just as the capacity for labour solidarity funds to invest in the economy and benefit from tax incentives also is the result of enabling legislation. And so on. These are not impermeable barriers.

²⁹ Launched in 2001, the FTSE4Good Index Series gathers more than 450 companies which are reviewed periodically to assess the extent to which they respect criteria on environmental sustainability and universal human rights (cf. www.ftse.com). Launched in 1999, the DJSI are the first global indexes tracking the financial performance of the leading sustainability-driven companies worldwide. Based on the cooperation of Dow Jones Indexes, STOXX Limited and SAM the DJSI provide asset managers with reliable and objective benchmarks to manage sustainability portfolios (cf. www.sustainability-index.com).

Table 3 : Synthetic overview of evolving sources of finance

Source	Examples
Solidarity finance	<ul style="list-style-type: none"> ▪ <i>Solidarity finance network</i> (Quebec) ▪ <i>Finansol</i> (France, 30,000 solidarity subscribers in 2001; 200,000 in 2005), <i>INAISE</i>, <i>FEBEA</i>, <i>Réseau financement alternatif</i> (Belgium, 1987), <i>Fineurosol</i> (2005)
Venture philanthropy	Program-related investment and social venture philanthropists (SVP) acting as investors in social enterprises (<i>Venture Experiment Program</i> by the Rockefeller Foundation, the <i>Acumen Fund</i> , etc.)
Institutional investors	<ul style="list-style-type: none"> ▪ Pension and insurance funds (shareholder activism) ▪ Donor-advised funds (DAFs): Pioneered by <i>Fidelity's Nonprofit Charitable Gift Fund</i> (donor activism) ▪ <i>Calvert Community Investment Notes</i> (1995, partnership between the Calvert Group and the Ford, MacArthur and Mott foundations)
Individual investors	<ul style="list-style-type: none"> ▪ Angel investors ▪ HNWIs ▪ 'Diaspora' financing ▪ Individual savers and investors
Social capital market	<ul style="list-style-type: none"> ▪ Patient capital/quasi-equity: <i>Fiducie</i> ▪ Blue Orchard's <i>Private Equity in Microfinance</i> and <i>NEsST</i>³⁰ ▪ ETHEX

³⁰ Blue Orchard has been working on a Private Equity in Microfinance consisting of a bond of about \$106m and backed by loans to various microfinance institutions. This bond will be available to investors worldwide through a sale being managed by Morgan Stanley, the US investment bank. The MFIs, which are based in Latin America, Eastern Europe and south-east Asia, will use the funding to make loans to individual entrepreneurs in their countries for mainly agricultural or urban business purposes (cf. www.blueorchard.org). As for the Nonprofit Enterprise and Self-sustainability Team (NEsST), it offers a venture fund that addresses the greater need for 'front-end' investment of both financing and other technical, capacity-building assistance of social enterprises from the inception of the self-financing idea through the point at which an enterprise becomes self-sufficient. With offices in various CEE and Latin American countries, NEsST also launched a Social Enterprise Competition in 2007 with a view on supporting the assessment of launching or expanding social enterprises activities (including any social economy organization that already has a business plan or a functioning social enterprise). Cf. Profits for Nonprofits: An Assessment of the Challenges in NGO Self-Financing (NEsST, Budapest, 1999) and <http://www.nesst.org>.

Chapter 4

A financial architecture for social enterprises: From social finance to sustainable finance

Social finance as a “grey zone” of action

In this chapter, we have provided an overview of the numerous sources of finance for social enterprises and the social economy in selected OECD countries. The portrait is complex, bringing together “old” and “new” actors in finance, modifying existing financial products and creating new ones to serve the hybrid needs and objectives of these enterprises and activities. In essence, we are tracking a moving target. Despite the growing capacity to describe the many initiatives under way by a large number of researchers and analysts worldwide, a synthesis is yet to be developed that captures the growth and evolution of this activity in a systematic manner. For now, we are documenting and classifying these initiatives into categories that are fluid and often overlap. Common to them all is the growing interest among many financial actors to invest in the public good, calling for new investment strategies and tools. Non-market social and environmental criteria, while difficult to measure, are driving this new market. This is particularly interesting given the grey zone in which this activity operates.

A clear definition or understanding of social enterprise, so often cited as a problem, is not a sufficient deterrent to reduce interest in supporting this new business form with enabling financial instruments and to be prepared to accept sub-market rates of return in many cases. Nor are the profit/non-profit silos that contribute to confusion given the new economic role assigned to non-profits and the social objectives adopted by private social enterprises. Institutional barriers, including legal form and ownership structure, not only make it difficult to accurately represent social enterprise as a new business model, but limit its ability to access different investment products, as we have pointed out. Financial innovation has produced new long term quasi-equity and/or patient capital products to address the inability to issue share capital, transforming a barrier into a challenge in this new financial market. These barriers can also be interpreted as cultural. The incompatibility of an existing investment framework tied to outmoded and fixed categories that do not correspond to the new reality of social enterprises and their investment needs, requires cultural adaptation of the financial, legal, accounting and policy communities internationally to this new reality before the appropriate and enabling tools can be designed.

The many obstacles that reduce the capacity to develop a coordinated market for social finance are also found on the demand side. For social finance to become *sustainable finance*, an integrated approach has to be adopted that is distinct from traditional capital markets. Investors in capital markets focus on returns, tracking the performance of enterprises and sectors, with some exceptions.³¹ Because of the hybrid nature of social enterprises and the constraints posed by institutional barriers, perception and underdeveloped markets, simply tracking the performance of these enterprises by potential investors is insufficient despite the increasing adoption of a different calculus for expected returns (triple bottom line, blended value, public good, etc.). The investor community can contribute to the viability and “investibility” of these enterprises more directly through a variety of means, including participation in multi-stakeholder settings (local and regional development intermediaries, for example) or collaborating with networks of social enterprises (sectoral or inter-sectoral). In other words, by integrating both

³¹ We referred to the labour solidarity funds in Quebec, for example, that we call “development finance” or “development capital” because of the engagement with the enterprises in which they invest and their commitment to local and regional economies. We suggest that this is similar to social finance in that the enterprises selected must satisfy socio-economic criteria such as job creation, environmental protection and/or economic development.

sides of the market - demand and supply - investors have better access to their potential market, thereby reducing both the perceived and actual risks of investing. But more important, the development of a social capital market takes a different and significant turn if it is designed as a process of *co-construction* within integrated networks of social finance and social enterprises. Not only would this reduce transactions costs considerably for investors, such a process would also provide much needed support and infrastructure for social enterprises.³² In addition to the institutional and legal barriers that we have identified, technical assistance, business development and development of markets are needs expressed by these new enterprises.

There is evidence of the success of implementing such a strategy of *co-construction*. In Quebec, for example, the creation of new financial tools for the social economy and social enterprises has occurred within multi-stakeholder inter-sectoral and territorial institutional settings that have designed financial instruments to correspond with the needs of collective enterprises. At the same time, those engaged directly in finance continue to work closely with these enterprises to develop markets through a variety of means, now that these instruments are in place. Still there are two major concerns: first, that the growth of the social finance market will outpace the capacity for social enterprises to effectively meet their goals and generate returns to investors if they are unable to develop markets for their goods and services and second, how to develop social enterprise as an alternative business form that challenges the predominance of private market-driven enterprise as the only viable model.³³ Therefore, not only do the financial actors need to coordinate their activities through intermediaries, networks or federations to reduce many of the asymmetries that currently characterize this emergent market, as we have suggested, but growing evidence confirms that they must also work in close proximity with the social enterprises in which they will invest. The success of social finance investors obviously hinges on the success of these enterprises that, in many cases, have yet to fully establish markets for their goods and services.

The following table summarizes some of the investment barriers and challenges and proposed ways to meet these challenges. We have selected those most commonly cited and add our own recommendations to those documented in the literature.

³² As Gair (2006) points out, investors act based on three elements that include the risk/return profile, organizational lifecycle and co-financing strategies (other investment sources). In this light, in order to develop a social investment market for social enterprises, investors' risk/return profiles must be aligned with the risk/return goals of social enterprises. The phases and cycles in the life of social enterprises need to be understood and the various contextual factors brought into the long term analysis. Financing represents one of those factors but not necessarily the most decisive for the sustainability of the organization (Gair, 2006).

³³ In Quebec, the Chantier de l'économie sociale is the "node" for an integrated approach to the development of the social economy through the development of numerous enabling tools, including labour market training, enterprise services, partnership research with university researchers and, of course, finance. In the case of the Fiducie, for example, all these tools assist in guiding the investments undertaken. Moreover, because the Fiducie works directly with local intermediaries, it can more easily identify problems and help to address them, thereby increasing the capacity for enterprises to access this new source of long term capital investment.

Table 4 : Investment challenges and barriers

INVESTMENT BARRIERS	How to meet these challenges?
Risk	<ul style="list-style-type: none"> ▪ Enabling policy environment ▪ Links with local and regional authorities (subsidiarity reduces risk) ▪ Pooling of risk (i.e. co-financing strategies) ▪ Credit enhancement ▪ Creation of intermediaries ▪ Co-construction of supply and demand. (new institutional spaces for social finance and social enterprise) ▪ Partnership (multi-stakeholder) ▪ Knowledge creation and sharing
Measurement and Evaluation tools	<ul style="list-style-type: none"> ▪ Measure the Social Return on Investment (SRoI); Blended value; Double and triple-bottom performance; Social accounting (Enhanced Value Added Statement, EVAS) ; Return on Tax-Payer Investment (RoTI, to measure direct indirect and induced effects of government supported interventions) ▪ The <i>Dow Jones Sustainability Indexes</i> (DJSI, 1999); The <i>FTSE4Good Index Series</i> (2001)
Image of the sector	<ul style="list-style-type: none"> ▪ Supporting federations and networking (credibility, cross-investing, counseling, etc.) ▪ Professionalization ▪ Communication strategies
Recognition of diversity of investment tools	<ul style="list-style-type: none"> ▪ Create investment vehicles that respond to a diversity of needs (from micro-credit to patient capital)
Time	<ul style="list-style-type: none"> ▪ Address the burden of short-term indebtedness ▪ Flexible instruments
Lack of appropriate legislative and institutional frameworks	<ul style="list-style-type: none"> ▪ As social enterprise is a social construction, a legal framework is required that recognizes its specificity (if considered an exception in most laws dealing with cooperation) ▪ Fiscal advantages ▪ Horizontal policy environment at national, regional and local levels

← - - - Mise en forme : Puces et numéros

Institutional innovation in the social finance sector

Throughout this chapter, we have explored innovations in finance with specific reference to the tools required to meet the financial needs of social enterprises. But a recurring theme has been the need for *institutional innovation* that we have approached from several angles, such as the need for intermediaries, for federating or networking the many actors involved and for involving the social enterprises directly in the development of this new investment market. While specific reference was made to Quebec and the recent emergence of Fiducie as an interesting and important illustration of the importance of an integrated approach, calls for networking and inter-sectoral collaboration echo among the numerous many actors who recognize that this is indispensable to the development of

a social capital marketplace.³⁴ The model we are proposing transcends many already existing networks both nationally and internationally, particularly within the micro-credit sector, that demonstrate the increased capacity networks provide to member organizations and the benefit derived from lateral relationships among actors. But the need for an integration of investor and enterprise networks at local and meso levels is less present and much needed to harmonize the needs of social enterprise with corresponding financial instruments and to work collaboratively to develop markets for these enterprises to flourish. Most important is the increased capacity to argue for enabling, innovative and integrated policy measures. A silo approach is not appropriate as we have emphasized throughout this chapter. Tax legislation, tax credits, subsidies for those sectors that will always require active government funding are among the existing policy tools available to government to enhance and scale up social enterprises. Procurement is a measure increasingly adopted by many governments at all levels. Fiscal measures can also be applied to enable social finance to attract investors, but other important policy tools include various forms of credit enhancement, through loan guarantees, for example. And, as we have stated numerous times, legislative innovation is a critical policy piece that has yet to produce satisfactory results. Without these elements, we are left in a strange world of understanding what social enterprises are not rather than what they are. New legislation based on broad multi-stakeholder consultation has to affirm the structure and mission of these enterprises as it does for the investment community.

In summary, some specific policy measures that could be supported by governments at all levels should include:

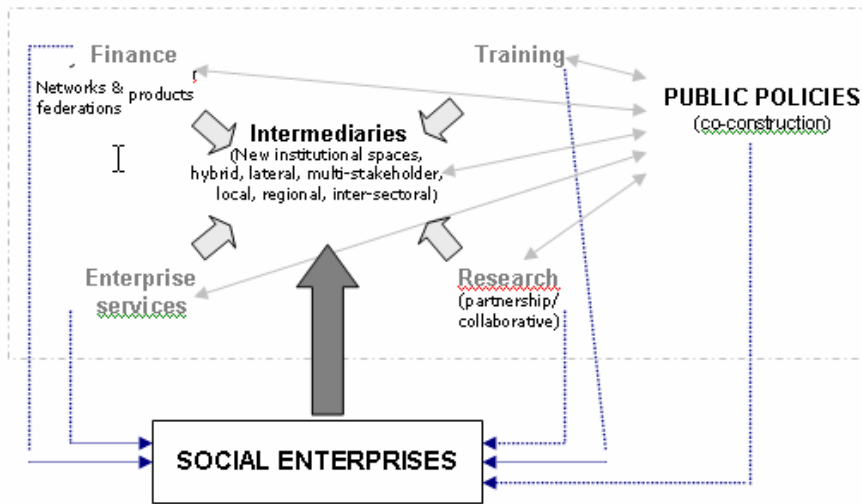
- Offering fiscal incentives to attract investors including traditional tax credits and subsidies and enabling tax legislation
- Offering multiple forms of credit enhancement (e.g. through loan guarantees)
- Developing public procurement measures that include socio-environmental criteria
- Developing legislative innovation based on broad multi-stakeholder consultation
- Supporting the creation of and participation in networks or federations nationally and internationally
- Spearheading and monitoring innovative institutional arrangements (e.g. public-private-community partnerships (PPCPs) between civil society, government and financial institutions and public-social enterprise joint ventures).
- Promoting a transversal or horizontal space for social enterprises within government structures to reflect their inter-sectoral nature
- Specifically for social enterprises, offering support services, financial advice, labor market training for employees, support for scientific research on crucial topics for the field
- Specifically for emerging social finance intermediaries and the investor community as a whole, offering support and training systems including technical assistance, business development and participation in the co-construction of markets.

In the diagram below, we present the elements of an integrated and systemic approach to social finance that calls for institutional innovation. Many of the obstacles we have identified above can be addressed in this context, especially cost and risk for investors as social enterprises have access to extensive support services, financial advice, labour market training for employees, and a research community working in partnership with actors in these new

³⁴ In Canada, the recently formed Causeway, a national coalition bringing together foundations, the credit unions, and networks of social enterprises to explore the development of such a market. In the US, a very important initiative is the creation of Wall Street without Walls in 1998 modeled after Doctors without Borders, that brings together expertise in finance to guide and support community based economic initiatives. Among their many achievements was the ability to get a Standard and Poors rating enabling \$50 million issue by a community development loan fund in Minneapolis (cf. <http://www.wallstreetwithoutwalls.com>).

and hybrid institutional spaces. Most significantly, investors transform a primarily clientelist approach they are often forced to assume in what are still more typically fragmented and differentiated markets. At a recent conference on developing social capital markets in Canada, participants explored “new sources of investment for social transformation”.³⁵ We suggest that to achieve this objective, institutional innovation is key.

Figure 2 : The co-construction of social finance: A systemic approach



³⁵ “Exploring new sources of investment for social transformation” was the title of a conference organized by Tides Canada Foundation, Ashoka and Vancity Credit Union. Social Capital Market Roundtable #2, March, 2006.

Conclusions

The objective of this chapter was not to provide a comprehensive overview of the available sources of finance provision to social enterprises. Instead, the aim was to analyze the leading trends in *social* finance that could potentially support the development of social enterprises in OCDE countries. By identifying the possible sources of financing for social enterprises, we have explored the conditions that enable their emergence, consolidation and development as well as the benefits for and/or constraints on social enterprises.

Regardless of the breadth of instruments available, the real potential of social enterprises will only be realized if they are integrated into a systemic approach to social exclusion, labor market transformation, and territorial (place-based) socio-economic development strategies that requires enabling public policy. Social enterprises must be recognized for their capacity to create socially inclusive wealth by all potential funders, although the ways in which this contribution is measured will differ based on the type of return sought by the financing organization (market returns, below-market returns, for example). Therefore, the issue of financing social enterprises is not to be addressed from an isolated perspective that focuses on financial transactions between lenders and borrowers (or recipients) but in the context of the integrated systemic approach we are proposing.

From an analytical perspective, the embeddedness of social enterprises in specific sociopolitical and economic contexts allows for a better understanding of the nature of support social enterprises might access. While in many countries this context is more permeable today given the search for solutions to reduce poverty and social exclusion, how social enterprises might fit into an alternative economic development paradigm is not only determined by this permeability or lack thereof, but primarily by the actors who are driving this new business model. Research should, therefore, have the double aim of describing the sector (i.e. taking stock of innovative instruments developed by the various providers of finance) and analyzing its transformative capacity.

We have emphasized the context specific nature of the evolution of social enterprises. That said, the need for international comparisons is indispensable, not only to share knowledge and expertise, but to assure that social enterprises are not presented as homogeneous and undifferentiated both within and between countries and that their financial and investment needs are complex, reflecting the different sectors of activity in which they are involved, their stages of development, capacity to generate trading income, etc. It is through networking nationally and internationally that the emergent and rapidly growing social finance sector can benefit from other experiences to design tools and instruments that correspond with their specific environments. We noted the important role played by federations such as the FEBEA and EMA (European Micro-credit Association) and large networks such as INAISE. But transversal networks such as IRIS, an intersectoral “network of networks” of responsible economy initiatives founded in January 2007, have gone much further in this regard by integrating social finance, social enterprises, fair trade actors and different levels of government - local, regional, national and supra-national - thereby engaging in direct dialogue with public institutions on strategies of social inclusion and poverty reduction.³⁶ This innovative network of networks also promotes mutual training and support while sharing best practices among members. In many ways, IRIS has created the hybrid institutional space that is necessary at local and regional levels. These are more than dialogic spaces; they institute processes of collaboration. How to translate what are often loose networks into institutionalized arrangements remains difficult in this still evolving environment. That said, the

³⁶ The IRIS Network links European and international networks representing different families of responsible economy initiatives: responsible finance (FEBEA, INAISE), Fair Trade (IFAT), responsible consumption (ASECO, URGENCI) and Social Integration Enterprises (ENSIE), with the participation and support of institutional partners (the Council of Europe and the Trento Autonomous Province, Italy).

need for instituting processes of collaboration is recognized by numerous actors, analysts and observers. It also calls for rethinking roles played by communities, researchers, the private sector and government. The “who does what” needs to be carefully constructed in this new environment. Processes of collaboration must be institutionalized.

Government is demonstrating interest in and capacity to re-arrange established institutional arrangements. The role of government has been questioned for more than two decades. Deregulation and reduced engagement in the public domain have not succeeded in resolving problems of poverty and social exclusion that have increased throughout this period. And so the proposals for and implementation of public-private partnerships (PPPs) in many countries. Governments at all levels have a privileged position for nurturing innovative organizational engineering. This now includes the possibility of developing public-private-community partnerships (PPCPs) between civil society, government and financial institutions, for example. Once again, there are precedents for this and in many cases, the architects of these new arrangements are social actors. Governments are buying in because of the clear value-added in institutionalizing these relationships. Another possible arrangement could be public-social enterprise joint ventures for those social enterprises engaged directly in social service provision and/or work integration of disadvantaged populations.

Institutional innovation on the part of government and an enabling regulatory and legal environment ultimately depend upon political commitment. In the case of countries of Central and Eastern Europe (CEE), for example, some lessons learned highlight the need to avoid relying on a unique type of financing, such as micro-credit. In high-risk market conditions such as the ones characterizing most transition economies, such reliance can generate a ‘debt trap’ in the absence of enabling public policy to permit micro-credit to leverage larger and more stable sources of financing, both public and private. Moreover, the rapid accumulation of wealth and philanthropy in some of these countries, often seen as the principle means to support social inclusion actions via social entrepreneurs, may also create perverse results without appropriate enabling social and economic policy. These caveats confirm the need for careful monitoring of these strategies that are being adopted too quickly in many instances, in our view. For social finance to play a role in these still fragile economies, they must both be integrated into an economic transformation strategy and carefully monitored. Whether such monitoring comes from peers or from public agencies is to be evaluated based on each national context.³⁷

Similar concerns must be raised in the context of other OECD countries where too often, social enterprises are limited to activities for training and work integration. Lessons in the United States are important in this regard as the CDFI movement and the growing network of community finance institutions supporting community based initiatives demonstrate. Paradoxically, it is also in the US that social enterprise is identified with a social purpose business model or with non-profits providing social services that develop capacity through trading activities. The community link is, of course, present but the focus is on individual enterprises and/or individual entrepreneurs. While many of these enterprises are anchored in their communities, they are not part of an integrated development strategy and risk slipping into those silos that potentially limit their transformative capacity.

In this chapter, we have identified numerous sources of financing social enterprise, those that currently exist and those that are potential sources of capital but have yet to engage in this market. Our research confirms the complexity of this evolving social finance landscape and the many conditions necessary for it to achieve its goals. To summarize, these include the need for a diversity of sources and products to avoid the pitfall of relying exclusively

³⁷ ILO’s Project Social Finance for Support to Self-Employment and its publication “Microfinance in south-eastern Europe: How small business helps to create jobs” provide a good overview of some transnational initiatives carried out in Bulgaria, Romania and Serbia. Cf. <http://www.ilo.org/public/english/region/eurpro/budapest/employ/socfin.htm>

on one instrument and to allow for the leveraging of capital, so important to the consolidation and growth of these enterprises. We have repeatedly returned to the importance of intermediaries and to the need to create networks and federations. International cooperation and the sharing of knowledge are contributing to the evolution of this activity and to a better understanding of the broader needs of social enterprises that must be met. A study by the United Nations Development Program (UNDP) on how to promote social enterprise in CEE and the Commonwealth of Independent States (2006) emphasized the need for technical assistance. For a social capital market to take shape, standardization, evaluation and innovative measurement that reflect the nature of these enterprises are critical. Research and education are also indispensable. Numerous university programs on social enterprise, social entrepreneurship and social finance have been created in recent years that both increase research capacity and have begun the important work of introducing these new organizational forms into business schools and social science programs.³⁸ Finally, there cannot be enough emphasis on the need for policy, but especially for policy innovation. Indeed, fiscal measures exist that can be applied to this activity, but as we have underscored, often even those fiscal measures are limited because of legislative barriers, for example. The same holds true for the much of what is currently on the policy menu. And so the need for innovation. This work must be done and it must be done in tandem with the growing interest in social enterprise and social finance. The cost of not doing this is very high. This means working inter-sectorally and horizontally to reflect the hybridity of these activities; it means working outside the box.

We cannot overemphasize the need for a broad approach to avoid pigeonholing social enterprises into discrete and limited activities. Because many governments are enthusiastically embracing social enterprise as an innovative means to reduce poverty, there is growing concern that this will be reduced to activities for the disabled (Defourny, 1996). Local authorities often make funding decisions contingent on the level of disadvantage addressed by these enterprises, and so on. The tasks ahead are numerous. In our view, the most important objective for researchers, analysts, observers and those directly involved, is to work on the many issues we have raised simultaneously. Only then can we conceptualize a model for social transformation that includes new forms of financing for new forms of business. There is a need for policy reform. Even the most ardent defenders of the welfare state agree that new modalities to preserve its underlying values and commitments need to be invented. If social enterprise and the financial instruments that are emerging to capitalize their activities are perceived as part of a renewed commitment to social citizenship and equity, the challenge ahead is to build the social, financial and policy architecture to meet these objectives. The 21st century then becomes a moment for creativity and innovations as social enterprises and the social finance sector are integrated into a political economy of citizenship. Needless to say that perceived risk, still the principal obstacle facing social enterprises seeking financial investment, will be considerably reduced in this new and enabling environment.

³⁸ There are numerous examples. We cite only the Institute for Social Banking in Germany that has developed a Masters in Social Banking supported by INAISE members, banks and foundations of the School for Social Entrepreneurs in various cities of the United Kingdom, the Center for Social Innovation (Stanford University), and Harvard University Business School. For an overview of educational programs, see the "Social Entrepreneurship. Teaching Resources Handbook" recently published by Ashoka (<http://www.universitynetwork.org>).

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