Standing Senate Committee on Social Affairs, Science and Technology

Public hearings on the creation of a social finance fund

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Thank you for this opportunity to exchange our views with you today on this subject.

My perspective is that of an academic specialized in social economy evaluation and financing, but also as a practitioner in several areas of social finance. I am a university professor in Social economy and in Management of social and collective enterprises, and I am one of the Research directors at the Center for research in Social Innovation (CRISES), an interdisciplinary and multi-university research network in Québec. I am a former Canada Research Chair on the Social Economy and current President of the CIRIEC International Scientific Commission on Social and cooperative economy. I am also currently working with international agencies (International Labour Organization, OECD, European Commission) on the conceptual design of statistical frameworks for measuring the size and scope of the social economy sector.

Also, for more than 15 years, I have been sitting on a weekly basis on the advisory boards of two social economy funds in Québec. The first one offers financial support for emerging enterprises and the other that offers long term financing for their start-up, scaling and growth. I have examined hundreds of social enterprises business plans and followed their viability over years. I have conducted an in-depth longitudinal study of the social performance of a social fund (Bouchard et al. 2017a and 2017b). In my work, I have created databases, integrated and harmonized databases coming from social enterprises as well as financial and regional development agencies.

In the following minutes, I want to share with you some of the conclusions coming from my work and observations. 1) A first is that social issues can, at least in part, benefit from social finance. I will explain the relations between social enterprises, social innovation and social finance 2) A second is that social finance can be truly innovative. I will illustrate this by referring to the case of the Solidarity Finance sector in Québec. 3) My conclusion is that a social finance fund can be useful. Governments can be instrumental in supporting the varied social innovation ecosystems that are emerging in different parts of the country and in helping create new ones where they are needed.

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1 Some of my work involved: identifying and qualifying social economy enterprises (before a legislation was voted on the sector) (Bouchard et al. 2011); developing a framework for evaluating the impacts of social finance institution, based essentially on data collected by the institution (Bouchard et al. 2017a, b); enabling multi-level analysis on 500 case studies on social innovations developed by CRISES over 30 years of research (Bouchard et al. 2015). I also have conducted a longitudinal study of social economy enterprises in the Montreal area between the years 2007 and 2011, measuring their survival rate after the 2008 crisis (Bouchard and Rousselière 2015, 2016; Rousselière and Bouchard 2011 a, b).
1. What are the relations between social enterprises, social innovation and social finance?

Social enterprises can be defined in various ways, but their basic characteristics can be summarized in three general features: social goals, profit-constraint, and democratic governance.

- Some have all three features, such as many non-profit, cooperatives and mutual organizations;
- Some have two, such as share-capital owned corporations that carry social goals and have profit constraints;
- Some only have one, such as so-called “social businesses” that are financially independent but aims at serving social and environmental goals\(^2\).

Social enterprises, in their various forms, are not new. But they are more and more considered as a one of the key players in the matter of finding innovative ways of addressing economic, social, environmental, and commons issues. However, their three constitutive features also limit their capacity to easily access the financial means that are required to innovate, grow and diffuse these new solutions at a scale that will make them meaningful.

For legal reasons, financing such enterprises poses challenges. For one thing, non-profit organizations do not issue shares and cannot accumulate financial reserves. In the case of cooperatives, interest on shares is limited and benefits are generally reinvested in the enterprise, ensuring that any retained surplus or residual value will not be appropriated for private benefit of members (asset lock). In all cases, social enterprises give primacy to their social goals over financial benefits; benefits being conceived as a tool to achieve social goals, not as a goal itself. As they tend to respond in innovative ways to new unmet needs, they are typically hybrids if not one-in-a-kind, which poses inherent, conceptual challenges to comparisons and ratings.

Such perspectives ward off usual investors and traditional financial institutions. Social enterprises are therefore faced with problems of credit rationing and credit constraints (Fedele and Miniaci 2010, Maietta and Sena 2010). Options for capitalization are limited to short- and medium-term debt. Accessing the much-needed long-term investment is difficult (Mendell and Barbosa 2013). Indeed, conventional financial institutions do not know how to estimate the risk level of such projects (Cornée 2017, Harji and Hebb 2010). Finding a financial institution capable of supporting social enterprises is therefore crucial, namely in their start-up and growth stages or when they require cash flow for new projects.

Social finance can help reduce this gap. The term “social finance” captures a wide range of financial instruments and institutions seeking triple bottom line returns, in terms of economic, social and environmental goals as well as of governance standards. In many cases, investors are ready to trade off part of the financial return for more social return, looking for what is called a “blended value” In practice however, such social finance institutions find it difficult to face the quadruple challenge of 1) investing small amounts, in what are perceived as 2) high risk projects, that offer 3) low financial return, in the 4) absence of an investment pipeline that enables scaling up impacts (TIRESIA 2017).

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\(^2\) Profit limitation, asset lock, and democratic governance can be seen as providing a form of “mission lock”, the idea that the organization will in the long run continue aiming at social goals (see Bouchard et al. 2015).
There is therefore a need for a support environment in which social innovators, social finance institutions and government can work together. Such “ecosystems” are emerging in many parts of Canada. I will illustrate how such ecosystems work by referring to the case of the responsible and solidarity-based finance ecosystem in Québec.

2. The Solidarity Finance Network in Québec. A set of funds and support organizations

Demand and supply

The financing ecosystem is the interface between the demand and the supply of services that help social economy emerge, thrive and grow. On the demand side, local social and collective entrepreneurs identify needs and put forward innovative solutions for their communities. Technical resources must be present to support the emergence of such enterprises, from incubation to cruising speed. These resources help structure the business plan, provide training, help improve the quality of management and governance and finally help connect the entrepreneurs with the available funding sources.

On the supply side, experience indicates that it takes a diversified set of financial institutions to meet the needs of social economy enterprises (Dorion 2016). These various players act differently and in a complementary manner according to their openness to risk, their performance requirements, and according to their target markets in terms of size and development stages. This syndication of complementary financial partners makes it possible to support social enterprises, with their varied needs.

Scale, leverage and impact

The Québec network of solidarity funds offers financing of various sizes, from 3,000$ to 50,000$, 100,000$ up to 1.5 million $ though this ceiling is rarely reached.

For example, MicroEntreprendre, the Québec network of community credit created in the year 2000, is the first step for micro entrepreneurs who do not qualify for traditional financial services. In 15 years, it has offered small loans of 3,000 to 6,000 $ to almost 2 500 projects, 89% of which have been reimbursed in full. In addition, MicroEntreprendre provides training to existing or potential entrepreneurs. Overall, it has accompanied near 24 000 entrepreneurs, thus contributing to their social reinsertion. The overall initiative has brought an estimated 130% in tax return as a result of individuals who were on social security having become taxpayers (Dorion 2016).

Another fund, RISQ, le Réseau d’investissement social du Québec, is exclusively dedicated to social economy non-profit and cooperative enterprises. Created in 1997, RISQ’s original endowment of 7 M$ was provided in equal parts by donations from private banks and enterprises and by the Québec government, who renewed an injection of 5M$ in 2014. Since 1997, RISQ has invested more than 27 M$ in over 1000 projects, initiated by 800 social enterprises. Our study of RISQ shows that targeted

3 Source: [http://www.microentreprendre.ca/](http://www.microentreprendre.ca/)

4 Those were the Desjardins cooperative credit unions’ movement, a private bank, a pharmaceutical foundation, an aluminum producer, a cigarette producer, and a circus.
projects respond to unmet socioeconomic needs, bringing essential goods and services to individuals and communities, offering alternatives in otherwise over-concentrated markets, providing training of jobs to people generally excluded from the work market; most of them in economically fragile areas.

Uncollateralized and long-term loans are mostly used to make a down payment on equipment or a real estate transaction, or to replenish liquidities. It is traditionally considered as risky. Once such a loan has been authorized, other financial institutions make up the rest of the total investment required to develop the project with their usual guaranties and collaterals. For each dollar invested by RISQ, up to 26 additional dollars were invested by its social finance partners, an average of 13$ to one dollar invested by RISQ\(^5\).

The experience of RISQ, was helpful in creating in 2006, the Fiducie du Chantier de l’économie sociale, of which the endowment is also mixed, composed of both private and institutional investments and a contribution from Canada Economic Development. The original endowment of 56 M$ has grown today to almost 100 millions $ (95,5 M$). So far, the Fiducie has invested close to 50 M$ in over 190 projects worth a total of 337 M$, amongst which supporting innovative housing solutions.

**Risk assessment**

All financial institutions have to evaluate *ex ante* the riskiness of projects, and do *ex post* follow up of borrowers in order to minimize capital write-off. Based on the proclaimed values of the social economy, the Québec solidarity finance institutions developed a methodology for analysing social economy enterprises. Two sets of indicators are developed. One set captures the social aspects\(^7\) and another the financial and managerial viability of the organization\(^8\). In the conventional mindset, social purpose is seen to oppose financial viability. In this framework however, they prove to mutually reinforce one another\(^9\). Not only that, the data that is collected by the financial institution for this purpose is (almost) readily usable to measure the social impacts\(^10\).

**The Guide for analyzing social economy enterprises** (RISQ 20003 and 2017) was co-constructed by social investors and social economy support organizations. It formalizes tacit knowledge generated by years of experience with social entrepreneurs. This Guide is today used as a reference for all of Québec solidarity financing institutions and it also

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\(^5\) This was calculated as such: average amount of project minus RISQ’s contribution, divided by average amount financed by RISQ. See: Bouchard et al. 2017a.

\(^6\) See : http://fiducieduchantier.qc.ca/

\(^7\) The mission, its operational response to a demonstrated need, the quality of its associative life and of its governance, its roots in the community, the quality of supports and the capacities of the board of directors (RISQ, 2012, 2017).

\(^8\) The quality of management, the technical and budgetary feasibility of the project, the presence of a demand for the products or services, the comparative advantages of the proposed response, the quality of human resources, the reasonableness of financial needs and, in the case of loans, the repayment capacity (RISQ, 2003, 2017).

\(^9\) Even if it is not the sole explanatory factor, our study shows that projects completed with success (fully reimbursed loans) obtained a higher rating on these indicators than the projects that ended up being written off (Bouchard et al. 2017).

\(^10\) For our research on social finance impacts, this data proved to be robust and homogenous enough to be aggregated. As well, it was specific enough to not betray the diversity of social enterprises’ social missions. Our concern was also to not overburden the financial institution or the financed entrepreneurs with complex data collection requirement, which imply for them substantial organizational costs.
serves as a reference outside Québec as it has been translated into 6 languages (English, Spanish, Portuguese, Catalan, Korean, Japanese).

The financial return of social finance is more than acceptable. In the case of RISQ, the percentage of write-offs (24%) is similar to that of similar funds, and the interests earned offset and exceeded the losses due to the write-off of capital. Even if the populations in comparison are not identical, these ratios compare well with the conventional venture capital industry, according to which, out of 10 financed projects, “two will prove resounding failures, six will come to life for some time without ever really taking off and, finally, two will be a great success allowing investors to get a return on their investments.”

Partnership, decentralized governance and knowledge exchange

One of the keys to this model resides in partnership and decentralized governance. Each financial institution is independent and has its own governance structure. They can also have an investment committee, formed of members coming from various horizons such as development support groups, financial partners, social economy enterprises, subscribers (e.g. government representative). Together, they form a network called CAP Finance, a structure emerging from a previous Community-University Research Alliance (CURA) on the Social Economy. This network helps actors coordinate and promote responsible and solidarity-based finance as innovative and alternative practices within the world of finance (Zerdani & Bouchard, 2016). A Working Group on Solidarity Finance is also active inside the Liaison and Knowledge Transfer Organization Territoires innovants en économie sociale et solidaire. Knowledge sharing and transfer proves to be inseparable of social finance.

3) Conclusion

Social enterprises and social finance can make a big difference in the future of our societies. This deserves the full attention of government as well as of other important stakeholders, starting with social entrepreneur themselves. Government can support social finance by de-risking, taking first losses, providing loan guaranties, etc….and by injecting funds to raise the potential of existing funds and help create new ones. Social investors and social innovators can exchange knowledge about how it works, focusing on how communities express their needs and learning from how they envisage creative solutions.

Initiatives are burgeoning everywhere, in regions of Canada as well as in other countries. It is time to learn from each other. There are many ways of designing social finance and we have to develop our own way of doing it.

Social innovation calls for innovative finance. « We can't solve problems by using the same kind of thinking we used when we created them. »

Thank you very much for your attention.

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12 See Groupe de travail sur le rôle de l’État québécois dans le capital de risque (2003), p. 16.

13 Albert Einstein.
References


