

How Does Social Enterprise Translate to the Charitable Sector?

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Introduction

I write this article with some trepidation as it questions the practical application of social enterprise (SE) for registered charities. Among the varied interpretations of SE such as fee-for-service programs, co-operatives or business sponsorships is one where it ostensibly is a cause unto itself. Despite the good intentions of self-identified SE practitioners, I feel a professional responsibility to ask how SE translates to meeting a public benefit mission and caution engagement by both charities and groups that represent the interests of the charitable sector.

One of the consulting services I provide is guidance on Canada Revenue Agency (CRA) policy which is a continuance of my past involvement with CRA's Charities Partnership and Outreach Program. Contrary to the perception they are in place to protect tax revenues or the interests of private business, I view CRA regulations as being reflective of the nature of achieving charitable purposes and quite enabling for organizations with public benefit missions. I also believe greater community impact is a corollary of independent regulatory oversight which ensures appropriate stewardship of charitable resources and an even playing field.

It is in this context that I feel the need to raise awareness of the apparent conflict between the achievement of charitable goals and the common characterization of SE - the marketplace sale of goods and services by a non-profit. I am all for new and innovative ways to accomplish social good but I have not seen any case put forth by promoters of SE that concretely, to use a popular SE axiom, *blurs the line* between business and charity; that SE furthers charitable goals without qualification as to its public benefit; that social outcomes would be guarded against for-profit motives.

When speaking with various interests about SE, it is usually at this point - the mention of CRA policy - when a sense of obstruction to social good sometimes surfaces and the conversation takes an irreversible turn. The reaction is akin to one you would expect if advocating to not feed hungry children or save abused animals hence my apprehension in broaching this topic.

As a consultant for charities and a long-time community volunteer, I am acutely aware that passion for a cause is the foundation of charitable organizations, without it they simply would not exist. That being said, there needs to be some objectivity to direct this passion effectively at an organizational level, and, just as important, a regulatory one. I feel this is particularly apropos when business activity, and the unbridled optimism and sense of empowerment that go along with it, is seemingly thrown into the mix.

Through what I hope will be construed as a lens of impartiality, I see a number of issues potentially emerge from the aforementioned conflict of SE and charity that should be of concern to sector stakeholders:

- inequitable distribution of government and foundation funding
- an increase in competition for fundraising dollars through activities operated outside the scope of CRA's **Fundraising by Registered Charities** guidance
- the use of social capital (funding, donations, and volunteerism) to fund business ventures and cover business expenses
- all of the above exacerbated by the inclusion of non-charitable entities into the realm of social good delivery

There are a number of questions that arise in a discussion about SE and the charitable sector:

Is there any difference between registered charities and non-profit organizations? Who regulates these entities?

What is social enterprise, or more specific, the foundational concept behind it?

What types of activities are charities allowed to do? Is charity simply a handout to those in need funded by grants and donations?

Can the 'social' aspect of SE be achieved by charitable activity? Can this be supported by targeted grants and financing?

I will attempt to put clarity on these questions and other key topics related to the article's theme. My goal is to impress upon the charitable sector and other interested parties the need to explore SE on a practical and strategic level, rather than an emotive one; as a concept rather than a cause.

Part 2: **The Regulatory Environment**

Disclaimer: I am not a lawyer nor connected with the Canadian Revenue Agency. I am not offering any opinions as to what types of activities would or would not be in compliance with federal or provincial regulations. I strongly recommend to all organizations to review relevant CRA and provincial/territorial policy, contact CRA and/or their respective provincial/territorial agency for further clarification, or seek legal advice.

Overview

I often run across situations where an organization appears to be or is considering operating an activity that may be offside of CRA regulations. I feel a professional responsibility to bring this to their attention and provide them with a link to the relevant regulatory resource in the same context mentioned in the above disclaimer. I shall endeavor to apply the same approach for this article - to bring attention to areas of the legal environment relevant to the article's theme while suggesting these areas may need close examination by organizations and other sector stakeholders.

Including content about legal structures and legislation is necessary and unavoidable in my view as SE in name alone presumes a marriage of business with charity, of capitalism and social good. This seems to be contradictory to regulatory policy that reflects a philosophical view that these concepts are fundamentally different, if not opposite, necessitating the clear legal line drawn between them. Also requiring clarity is use of the term 'non-profit' in SE resources and narrative is not necessarily limited to the legally incorporated entity of the same name.

Not surprisingly the subject is well represented in SE resources where its ideas and existence are seemingly supported by, or perhaps born from, terms and conditions in legal policy and activities operated by charities and NPOs. The Business or Non-Profit Model Continuum is frequently mentioned as blurring or passing through the line between charity and business.

It is important to preface any discussion about SE and the legal environment with recognition that:

- there is no legal definition or structure for SE in Canada
- SE is not recognized as a charitable purpose in Canada
- there is no universally accepted SE definition

The significance of the last point is illuminated in the diverse characterizations of SE that includes for-profit entities and organizations where social purposes are not necessarily achieved through the sale of goods and services. From a legal perspective this would appear to encompass the whole gamut of incorporated entities, both taxable and tax exempt, and their activities.

Registered Charities and Non-Profit Organizations

Author's note: Although there is a difference in the terms 'community' and 'public' in CRA policy for registered charities, they are both used regularly in charity sector and general dialogue, along with 'social', to describe activities that may fall under one of four heads of charity (the relief of poverty, the advancement of education, the advancement of religion, or other purposes that benefit the community) which is the context in which I will use them.

The significance of this topic is precipitated by the prevalence of NPOs and use of the term non-profit in SE definitions, narrative and resources, and the tendency to view registered charities and NPOs as interchangeable, or "cousins", as one SE promoter puts it, in the arena of social program delivery. I ascertain a number of reasons for this, all intertwined:

- the 'social' part of SE presumes a public or community benefit associated with the work of NPOs and registered charities, which themselves are usually, but not exclusively, incorporated as NPOs
- the legal requirement for an NPO that it cannot distribute any of its income for the personal benefit of its members is viewed in the same spirit as, or is possibly the inspiration for, the frequently stated SE concept of 'social' profit distribution
- 'non-profit' is used in a broader and non-legal context to describe organizations that aspire to 'social' profit distribution
- the inclusion of the term social in the Income Tax Act which states NPOs be "organized and operated exclusively for

social welfare, civic improvement ... or any other purposes except profit” even though ‘social welfare’ is usually interpreted to mean a gathering or get-together rather than community or public benefit

- a number of support groups and government agencies serve both NPOs and charities, often using ‘non-profit’ as an umbrella term

All of these contribute to the impression that non-profit assumes charitable benefit despite the inclusion of NPOs that do not have public benefit missions, notably member-based ones such as sport groups, professional/industry associations, and social clubs like a bridge club.

Are registered charities and NPOs the same thing?

I believe it is not well understood these are defined and treated differently under the Income Tax Act, and, as mentioned above, being an NPO is not a prerequisite for obtaining charitable status. Making things more confusing are the dynamics of provincial and federal incorporation and regulation which will be discussed in the next section.

A key distinction is an NPO “is not a charity” according to the Income Tax Act which in theory puts organizations with public benefit missions (i.e. would qualify to be registered as a charity) under a higher and public benefit purpose-based level of external scrutiny. In my opinion, CRA’s stringent accountability and transparency requirements are a necessity as registered charities are in essence using public funds and resources to deliver their programs and services. NPOs are generally viewed in a neutral light - while their purposes are not for-profit, i.e. business oriented, neither are they beneficial to the community or public when compared to charitable ones. Accordingly, conditions for an organization to be formally considered a NPO do not seem to be based on the achievement of public benefit.

I believe there are a number of NPOs with public benefit missions that could qualify to be registered as charities but choose not to apply. These organizations deliver programs and services similar to those delivered by registered charities adding to the perception of interchangeability. They likely fall into two groups:

- (1) Ones that receive government funding not contingent that they be registered as a charity. Assuming there are grant accountability and transparency clauses in place, concerns for their lack of oversight by CRA are alleviated to some extent even though there may be compliance issues with their NPO status.
- (2) Ones that operate revenue generating activities such as fundraising or a business which provide funds for their programs and services.

The second group presents a scenario where social capital (grants, fundraising revenue, volunteers, etc.) is being solicited and spent outside of the designed level of scrutiny and accountability. This means competition for fundraising dollars between registered charities and NPOs, who unlike charities do not need to account for their fundraising practices, creating an uneven playing field. The lack of external accountability for NPOs specific to social outcomes increases the risk of misused funds (i.e. not used exclusively for charitable purposes). NPOs from the first group could also enter into this mix if their government funding is reduced or they decide to diversify their revenue streams.

Should a public benefit organization become a registered charity?

Legal considerations aside, I would recommend to organizations with public benefit missions to seek charitable status from a strategic perspective. Along with the ability to issue tax receipts and apply for charitable foundation grants, it should also afford a higher level of public trust leading to more successful solicitation efforts. If an organization carries out some activities that would not meet charitable status criterion, they could consider housing those activities in an NPO.

Another consideration is the types of activities that can be operated to generate surplus monies. Imagine Canada, an organization that supports the work of charities, suggests NPOs have greater latitude as to how they can raise funds and cites, as an example, that CRA’s Fundraising by Registered Charities guidance would not apply. Perhaps this advice needs to be revised as there is a great deal of uncertainty as to what revenue generation activities NPOs are allowed to operate given the recent findings of CRA’s **Non-profit Organization Risk Identification Project**.

It has been opined in legal circles the rules for revenue generation by charities are much clearer and the same ones could be applied to NPOs, which on the surface would not give them any more fundraising leeway than charities (and likely adds adds similar accountability requirements). In this milieu, operating as a charity would appear to be more advantageous.

Federal versus Provincial Incorporation and Regulation

Incorporation and regulation in the provinces and at the federal level seems to add to this misunderstanding of charities and NPOs which in turn contributes to the presence of 'non-profit' related topics in SE resources. Provincial NPO legislation specific to operating commercial activity is often referenced particularly in sections covering potential SE legal structures.

Here are some relevant details about NPO and registered charity incorporation and regulation:

- NPOs can be incorporated either provincially or federally and must abide by their respective incorporation legislations which can vary from province to province and from provincial to federal
- regardless of incorporation jurisdiction, in order for an NPO to be exempt from paying income tax they must meet conditions set out in the Income Tax Act (which for simplicity will be referred to as federal NPO policy)
- NPOs seeking registration as charities, which includes tax exempt status, do so at the federal level via CRA and must abide by CRA policy for registered charities (rather than federal NPO policy) to keep their registration
- some provinces have their own rules for charities that apply in addition to CRA regulations
- according to the Constitution of Canada, provinces and territories are responsible for managing the operations of registered charities outside of registration

The last point garners particular interest as it appears to conflict with the reality of CRA's regulation of charities and is a good starting point to a discussion on some dynamics associated with this particular area of the regulatory environment.

Who should regulate registered charities?

In a recent speech by Cathy Hawara, Director General of the Charities Directorate, she stated while "the Constitution makes it clear that the responsibility for managing the operations of charities falls to provinces and territories..." the CRA has "become the de facto regulator by virtue of the federal government's taxation power and policy to provide tax incentives to support giving to charities."

Some question whether being both tax collector and administrator of tax exempt entities is a conflict of interest for CRA and suggest the regulation of charities may be better served by an independent commission or at the provincial level. Other than legal opinion that CRA goes beyond its mandate to regulate charities based on the Constitution, I have not heard of any conflict of interest claims or any calls from legal experts for changes to CRA policy specific to revenue generation based on the premise the policy only serves to protect tax revenues. I see the CRA rules as reflective of charitable nature and when understood, reasonable and rational.

Should regulation be removed from CRA's mandate? From a policy perspective only, I am not certain an independent commission would develop policy that would be significantly different from CRA's, some of which is based on consultations with sector stakeholders like the legal community and support organizations. The same probably applies to provincial regulation which also adds potential administrative challenges for national and regional organizations that would be operating in multiple jurisdictions. From a practical point of view, it makes sense to have one national regulatory body responsible for both registration and regulation. In a general sense, I think a similar analysis and thinking also applies for NPO's.

Is business activity by NPOs and registered charities encouraged at the provincial level?

The premise of business activity by NPOs and registered charities being encouraged at the provincial level comes up often in SE narrative. Likely it is based on the inclusion of terms like business and commercial in various provincial NPO legislation giving the impression of business activity being allowed at the provincial level despite rules or rulings to the contrary at the federal one. This can add fuel to, or be fueled by, the conflict of interest criticism directed towards CRA, and bring up calls for provincial regulation of charities and NPOs.

I believe this perception is contributed to by wording found not only in provincial NPO legislation but in federal NPO and charity regulations too. Even though they all include words and phrasing which appear similar, from province to province and from province to federal, I do not believe they are obliged to use the same terminology or in the same context.

In its policy for charities, CRA defines business as a "commercial activity—deriving revenues from providing goods or ser-

vices—undertaken with the intention to earn profit”. It also indicates which type of business activities charities are allowed to operate (as a related business), and the difference between business activities and activities that have business-like characteristics such as fundraising and charitable programs that charge a fee. Federal NPO policy indicates NPOs “must be both organized and operated exclusively for social welfare, civic improvement, pleasure or recreation or for any other purpose except profit”, but can carry on business “directly attributable to, or connected with, pursuing the non-profit goals”.

From this I would identify three concepts:

- (1) *Business* activity that is for profit and is not connected in any way to a NPO or a charity (simply directing profits to non-profit or charitable purposes is not considered a connection).
- (2) *Business-like* activity where fees are charged in the context of a charitable program or a NPO activity, i.e. in a cost defraying or non-profit manner, and the activity originates from NPO or charitable purposes rather than being incidental to them. Examples include YMCA memberships, museum admissions, community arena rental fees, university tuition, theatre ticket sales, and golf club or professional association dues. There can be profits or surpluses from these activities but must be incidental.
- (3) *Incidental Business* activity that is for profit and has an element of non-profit or charitable benefit as it is connected to an NPO or charity. For example, a hospital parking lot, a museum gift shop, or a canteen at a community arena.

It is important to note the difference in intent between charging a fee in the course of a non-profit or charitable program on a cost-defrayed or program focused basis and operating a *business* or an *incidental business* on a for-profit basis. These are two distinct, if not opposite, philosophies making necessary the legal partition of commercial businesses and registered charities, and the clear division of the two within NPO and registered charity policy.

Also note the term incidental is used in two different contexts; one to describe a profit or surplus that occurs unintentionally when operating a *Business-like* activity and the other to describe an activity where profit is intentionally generated.

In looking through NPO legislation for some provinces ‘business’ does not appear to be differentiated in a manner similar to CRA’s. Some appear to cover only *Incidental Business* activity while others cover only *Business-like activity*, while at least one mentions neither. This is my interpretation without legal assistance, I can certainly see how someone could interpret the same terminology to enable business activity.

This would appear to be a moot point as regardless of wording in their respective NPO legislations, NPOs must meet federal conditions to be exempt from income tax and NPOs registered as charities must comply with CRA policy for charities. At least one province recognizes this and clearly states it in their NPO legislation. Perhaps the lack of streamlined language between the provinces and from provincial to federal can be explained by a lack of necessity; as NPOs have to comply with federal rules, it is not as important that provincial legislation be as precise or up to date.

A look at NPO legislations for B.C., Ontario and Nova Scotia offers some insight into this dynamic.

In the B.C. Society Act, a society cannot have a “purpose of carrying on a business, trade, industry or profession for profit or gain” while “carrying on a business, trade, industry or profession as an incident to the purposes of a society” is not prohibited. Given the similar wording and context with CRA’s it seems clear this is referencing *Incidental Business* activity, the reference to ‘incident’ being associated with a for-profit activity rather than a profit or surplus from a *Business-like* activity.

In my view there appears to be alignment with CRA policy. In contrast, one SE resource references the B.C. Act as allowing “some commercial activity” that “runs afoul of the federal Income Tax Act and the Canada Revenue Agency” and cites this as an example of contradictory policies at the provincial and federal level.

Ontario’s new Not-for-profit Corporations Act (ONCA) stipulates if “purposes of a corporation are of a commercial nature, the articles must state that the commercial purpose is intended only to advance or support one or more of the non-profit purposes of the corporation.” My guess would be that different from B.C.’s Society Act, this covers *Business-like* activity - charging a fee in the course of a non-profit or charitable program. I base this on the use of the term ‘commercial nature’ rather than simply ‘commercial’, and the reference to ‘purposes’ and ‘articles’, making it more than just incidental activity.

A Government of Ontario guide to the new ONCA states the new Act clarifies “that not-for-profit corporations can engage in commercial activities if the activities support the corporation’s not-for-profit purposes” which in my view could be interpreted as being similar to B.C.’s Act, giving the okay to *Incidental Business* activities. However one interprets the wording, both the Government of Ontario guide and the ONCA makes it clear that an Ontario NPO must comply with federal NPO and charity regulations.

This guide is referenced in an SE resource developed by another provincial government as an example of a province enabling NPOs to engage in “commercial activity” that will reinvest revenues into “non-profit purposes” but lacks any context as to the type of business activity (presumably *Business* rather than *Business-like*) or any federal compliance considerations. In another SE resource the ONCA itself is referenced as an example of a province allowing *Business* activity for NPO’s and charities. I could see how these would create or perpetuate a sense of support at the provincial level for NPO *Business* activity.

The Nova Scotia Societies Act states an NPO cannot have a “purpose of carrying on any trade, industry or business.” This may be interpreted as prohibiting both *Incidental Business* and *Business-like* activity despite their allowance under federal NPO or charity regulations. It seems to be a well established legal opinion that this legislation is badly outdated and needs to be changed to be in line with current federal policies. I believe this opinion is misinterpreted outside of the legal community in three ways:

- (1) The updated version would allow business activity without any context or restriction.
- (2) The new legislation would (or should) be the only one that applies to Nova Scotia incorporated NPO’s.
- (3) If number 2 is not the case, federal rules must also be out of date and need to be revised to allow unrestricted business activity.

Distribution of income and profit/‘social’ profit

In my opinion, there is also misinterpretation of the federal NPO policy that no part of the income of the entity can be payable or available for the “personal benefit of any proprietor, member or shareholder.” This can contribute to the provincial/federal dynamic on two fronts:

- a connection to the SE concept of ‘social’ profit distribution noted earlier
- the perception that CRA policy exists only to protect income tax revenues and private business interests

Rather than benefiting business owners or shareholders, ‘social’ profits, according to SE narrative, are distributed:

- to the community at large
- to a non-profit/charitable/public benefit purpose
- in a more democratic manner
- to a marginalized community or group of people

As mentioned in the overview, organizations that intend to earn and distribute ‘social’ profits are considered ‘non-profit’ in SE narrative which is different from the legal context of the term used to describe organizations that meet the conditions in the Income Tax Act for NPO’s.

I believe business owners/shareholders in SE narrative and ‘proprietor, member or shareholder’ from the Income Tax Act are viewed in the same light which creates the perception that the only reason an NPO is not allowed to make a profit is that it would be earned tax-free. If the element of private shareholder benefit is removed from the equation then profit from an activity, be it *Business* or *Business-like*, can be earned without any limitation because it will be distributed ‘socially’. This can bestow a sense of legal integrity and of being a charitable purpose unto itself that renders any restriction on business activity inapplicable. This is sometimes referred to as the ‘destination of profits’ test.

Of interest in the B.C. Society Act is mention that “a society must not distribute any gain, profit or dividend or otherwise dispose of its assets to a member of the society”. In wording at least, this appears to be different than the federal NPO regulation that an NPO cannot distribute any of its income, the difference being ‘gain, profit or dividend’ versus ‘income’, which in my view, are two different financial concepts. The wording in the B.C. Act could be construed as an even more convincing legal affirmation of ‘social’ profit distribution.

I also believe the perception of CRA being conflicted by tax revenue and private business interests is perpetuated by, or perhaps originates from, this distribution restriction; that their only concern is foregone tax revenue and preventing tax exempt organizations from competing with taxpaying businesses entities.

In my view, what gets lost in these interpretations is the inclusion of ‘proprietor, ‘member’ or ‘shareholder’ is just as significant as the income or profit distribution element. I believe this is an obvious rule to prevent NPOs from being used to flow through tax-free business or personal income which would explain its prominent stature in federal and provincial NPO legislation. I do not see any practical reason to interpret it as a rule to simply prohibit NPOs from earning unfair profits.

Also, in meeting the NPO requirement specific to income distribution, the need to meet other conditions, most notably about operating activity that “is not exclusively for non-profit purposes” in federal NPO policy, and that charities can only engage in related business activities that accomplish or promote their charitable purposes, is not eliminated. In my view, it would not make sense to include conditions in contradiction of each other.

Incidental business

Incidental Business activity is a topic that garners considerable attention in SE resources as, depending upon legal interpretation, it presumably opens the door to unrestricted business activity for NPOs and charities so long as a ‘connection’ can be established.

Choosing to operate a *Business-like* activity as an *Incidental Business* (e.g. a fee-based charitable program as a related business) to generate surplus funds is a common example of a connection that I have noticed being made by self-identified SE practitioners. At first glance this would seem to make sense as the *Business-like* activity originates from non-profit or charitable purposes hence the connection. I think this belief is due to a combination of:

- the almost exclusive focus of SE resources on CRA rules for *Business* and *Incidental Business* activity (rules for *Business-like* activity are usually excluded or *Business-like* activity is depicted as *Business* activity)
- the perception that it’s technically okay for an NPO to earn a ‘social’ profit
- misunderstanding about a particularly complex model of revenue generation
- the common practice in non-profit sector statistical analysis to place revenues from both types of activities in one category usually called ‘Earned Income’
- opinion that this as a grey area for registered charities suggesting a lack of regulatory clarity

From a practical perspective, I do not see this as being a natural connection and would be surprised if it was identified as clearly allowable under current federal rules or by rule change. From a strategic perspective, I would caution that switching from a cost-defraying or non-profit intent to a for-profit one introduces risk of financial and social capital especially for organizations with public benefit missions.

This is one of, if not the main crux of the issues I see arising from the conflict of SE and charity which will be examined in greater detail.

Other legal entities

Broad definitions and interpretations of SE, along with equating ‘non-profit’ with ‘social’ profit distribution, bring other legal entities into the discussion. Co-operatives are sometimes described as the original SE with its democratic and generally communal distribution of profit. Co-operatives usually are for-profit but can be incorporated as NPOs and seek charitable status which would require them to follow the applicable regulations, seemingly eliminating their ability to generate and distribute profits for their members.

So-called hybrid and social purpose business organizations (incorporated as for-profit entities but identify themselves as having community or public benefit purposes) are mentioned frequently in SE resources as are traditional businesses that market social contributions such as charity sponsorships, SE funding programs or ‘fair trade’ on their corporate agendas. It is important to note for-profit entities, unlike registered charities, do not have external regulatory accountability mechanisms in place to ensure they are achieving their stated purposes or goals. Also of note is these professed social purposes or goals would not necessarily fall under one of the four heads of charity (to be examined further in Part 10 and 11).

Part 3: What is Social Enterprise?

Depending on who you talk to SE can be:

- the provision of essential goods and services by charities and NPOs
- the promotion of self-sufficiency for marginalized persons or communities
- a traditional business with a social mission or agenda
- the social benefits of economic activity
- the transformation of traditional charity
- all of the above and more

The combination of ambiguousness and what feels like the unquestionable integrity of SE almost makes this article a non-starter. There is not a universal definition for SE, it has many broad, sometimes contradictory interpretations, and it is well known that efforts to agree on a definition within the SE community have been going on for years. It can be identified by other names such as Social Impact organizations, Social Purpose Business or Community Impact Corporations. As mentioned in Part 2, every type of legal structure, taxable and tax exempt, are referenced in SE resources. Seemingly any kind activity operated by a for-profit entity, a NPO, or registered charity can be self-described as SE and there is not anybody, or more significantly any formal body, to dispute it.

In some SE narrative and resources, it seems to be more of a cause or credo rather than a tangible application. Sweeping proclamations that SE is 'business for good' that is 'responding to market failure' and could unleash 'billions in social investment capital' if changes to 'archaic charity regulations' were made seem to be far more prevalent than the nuts and bolts about what SE actually is, how non-SE business presumably is not good, the source of social investment capital, or a list of proposed amendments to CRA policy that challenge the foundational concept of charity. Charity sector stakeholders who raise questions about SE have been dismissed as "naysayers" and out of touch with the SE movement.

'Social' entrepreneurs are commonly described as just wanting to get on with achieving social impact, relegating consideration for appropriate corporate configuration as a secondary concern or even a hindrance to their work. According to one SE promoter, "rather than fitting into a specific legal structure, social enterprise is more of a verb"; an action it seems that is above reproach.

In this muddle of vagueness and 'doing good', it is a challenge to have a practical and strategic discussion on SE in any context, let alone on how it can be applied to registered charities.

The foundational concept of social enterprise

In searching for a foundational concept to determine what SE is, the only consistent and clear notion in resources and narrative is what it is not - a 'traditional' business whose sole motivation is to benefit its shareholders or, more aptly, does not make any kind of 'social' distribution or contribution. This means an organization incorporated as a for-profit commercial entity that:

- is not owned by a registered charity, or by a marginalized community or group
- does not have a democratic ownership model
- does not have a social or community purpose
- does not contribute socially either through its operations e.g. in an environmentally friendly manner or in an economically depressed community or region, or through gifts or sponsorships to community causes

It seems that any organization that has any of these qualities or features can describe themselves as a SE. By my count it includes businesses, hybrid organizations, charities, NPOs, and co-operatives. Trying to fit all of these under an umbrella term or fashion as a singular concept is a questionable endeavour in my opinion as there are many fundamentally different philosophies and intentions amongst them. This is best exemplified by the fact that a co-operative can be either for-profit, an NPO, or register as a charity.

In some SE resources, Business or Non-profit Model Continuums place SE in an area between ‘traditional’ charity and ‘traditional’ business but what seems to be lacking is recognition or understanding of:

- the context in which charitable or public benefit programs charge fees
- the context in which registered charities can fundraise
- the natural conflict between for-profit motives and public benefit purposes

It is not surprising that trying to come up with a universal definition has proven to be difficult and SE is not legally recognized in Canada.

Business activity

The ‘enterprise’ part of SE seems to presume business (or commercial or market-oriented) activity which also is consistently mentioned in SE resources, usually in three contexts:

- (1) The marketplace delivery of public benefit appears to be promoted as a strategy that can generate profit.
- (2) The operation of a *Business* activity to generate profits for a public benefit purpose (the ‘destination of profits’ test).
- (3) A traditional business that has intentions to do social good.

The first two are usually presented without any clarity or differentiation between *Business* activity and the *Business-like* activity of NPOs and charities. The focus seems to be almost exclusively on the earning and distribution of ‘social’ profits and the opportunities for capitalization that go with it. It is sometimes mentioned that SEs can be “mission-based” i.e. cost-defraying but it is positioned as by choice or motivation rather than by regulation.

While commercial activity appears to be a common premise of SE, particularly those associated with a registered charity or a NPO, other common definitions feature for-profit business activity as the defining characteristic of SE, one which does not rely on grants and donations but rather is supported by conventional capital financing. Conversely, there is at least one accepted definition where community benefits are not necessarily achieved through the sale of goods and services as social purposes or missions can be advanced via the traditional charity route of grants and donations.

Social enterprise and the charitable sector

SE has become effectively entrenched in the charitable sector by virtue of organizations self-identifying themselves or their activities as SE, or by being described as such by SE promoters. A number of organizations describe their initiatives, be it fundraising, an allowable business, or program-related, as SE; for others it appears in their missions; and for one it is their name. SE research projects are often cited as having identified numerous SEs that are registered as charities despite the lack of a legal or universally agreed upon definition. In dialogue and commentary, it is frequently mentioned informally creating a façade of its formal placement within the charitable sector.

Another contributor to this dynamic is inclusion of SE in CRA policy for registered charities. Its mention is viewed as formal recognition of SE and its legal standing as having public benefit despite it being included in policy for reference purposes only. CRA clearly indicates it does not have an official definition for SE, it is not recognized as a charitable purpose, and will be treated as such in a registration or auditing process. For all intents and purposes, charities self-identifying an activity, their mission, or themselves as SE has no significance.

Defining social enterprise

For the sake of this article, SE is defined as ‘the marketplace sale of goods and services by a non-profit’ which I believe captures the prominence in SE narrative of ‘social profits’ earned from apparent commercial activity.

Clarity is needed around the concept of marketplace and market. Even though they are referenced often in SE definitions and narrative, I have not found specific definitions for either term or any indication that there are marketplaces or markets that are specific to SEs. I believe it is reasonable to assume a marketplace or market is where goods and services are sold for profit in an open and unrestricted environment.

Part 4: Activities of Registered Charities - Overview

In SE narrative and resources, charity and the activities of registered charities are mentioned frequently usually under one of three premises:

- (1) Charity is portrayed as a handout and unsustainable given its reliance on grants and donations and is cited as a reason to engage in purportedly sustainable SE activity. This depiction is often placed at the beginning of Organization Spectrums and Business Model Continuums. Charity is also likened to programs with limited social impact or social return on investment (SROI).
- (2) Activities operated by registered charities are used as examples of SE seemingly giving credibility to its existence and equating its social impact the same as charities. Examples include fundraising, fee-for-service and employment-based programs, and related businesses. Unrelated businesses, separate taxable corporations established by charities, are also mentioned. Goodwill Industries, Girl Guide cookie sales and YMCA memberships are provided as evidence of SE being around for a long time in the charitable sector.
- (3) SE promoters suggest that CRA policy for registered charities is not enabling for SE due to its constraints on business activity.

Put together these references appear to be contradictory. On the one hand, the charitable sector would appear to be, if not the home or origin of SE, certainly a welcome host. On the other hand, the sector is viewed as not enabling for SE due to regulations or not conducive to the sustainable nature of SE activity.

I believe this apparent paradox is a combination of the ambiguous defining and interpretation of SE and the lack of awareness and understanding by SE promoters of the different types of activities that charities are allowed to carry out, specifically ones that include the sale of goods and services. Some common misunderstandings seem to be:

- any kind of sale of a good or service automatically opens the door to unrestricted profit and offers opportunities for capital investment
- selling a good or service in a charitable or cost recovery manner is not sustainable and limiting
- restrictions on business activity are tax related rather than born from the philosophical and legal foundation of charity

Parts 5 through 9 will examine the four types of activities that include the sale of a good or service, the context in which these goods and services are produced and sold, and how charitable outcomes could be compromised without limitations.

It is also important to preface content on registered charity activity by emphasizing that a registered charity's purposes must be exclusively and legally charitable, and must be established for the benefit of the public or a sufficient segment of the public.

Part 5: Activities of Registered Charities - Fee-based Charitable Programs

Overview

Programs that include fees provide goods or services that can advance charitable purposes. It can be an essential service that is identified as lacking in a community e.g. housing, daycare, or homecare; it can be to advance education e.g. the cost of attending a museum or a play. They are sometimes referred to within the sector as fee-for-service or service subsidized.

As mentioned in Part 2, choosing to operate a *Business-like* activity where fees are charged in the context of a charitable program as an *Incidental Business* is a common self-identified SE activity. The belief appears to be that along with charitable benefits being realized through the marketplace sale of a good or service, potential surpluses can be generated and used to fund other programs or, to use a common SE phrase, can be reinvested into the organization. The SE is viewed as having 'double bottom lines' or 'blended returns', a financial one and a social one.

Despite clear CRA policy, there appears to be a lack of awareness that for-profit motives can affect charitable outcomes; the direction of surpluses notwithstanding, there is a downside to intentionally generating profit (along with financial risk if investment capital is included).

CRA policy

In CRA's words "fees are charged in the context of many charitable programs. The presence of fees does not necessarily mean that a program is non-charitable or that the charity is engaging in a business activity. Programs remain charitable as long as they manifest the two essential characteristics of charity—altruism and public benefit."

There are a few key indicators that a charitable program is not a business:

- the fee structure is designed to defray the costs of the program (taking into consideration any government funding)
- the program does not offer comparable services in the marketplace
- fees are set according to a charitable objective rather than a market one

I believe the policy clearly indicates that in relation to the delivery of a program, charging a fee for a good or service does not automatically make the activity a business. Public benefit is compromised when intent is switched from charitable to business (i.e. cost defraying to for-profit) and/or fees are set based solely on market rates. The policy is not in place simply to deny charities from generating tax-free profits or competing against for-profit entities. As will be demonstrated, this approach also should not be viewed as inhibiting to operating an activity in a sustainable manner or bring to scale.

The stipulation a program should 'not offer comparable services in the marketplace' would appear to be in direct contrast of the SE characterization which places goods and services within the marketplace. I think it is obvious that a charitable program would not be offering a service that is comparable to another in the marketplace. Generally, they are developed when a service or good that could be of benefit to the community has been identified and is not provided by the private or public sector. The charitable good or service will usually be offered either:

- in a particular geographic area
- to particular group of people
- at an affordable rate i.e. below market rates

Further to the last point, CRA makes it clear fees for charitable programs must be "set in accordance with the users' means" and one program, **Housing That Relieves Poverty**, specifically indicates fees must be "at below market rate". My interpretation would be offering a good or service at an affordable price to an identified community or group would not be comparable to a service that charges market rates operating in the same community.

Fundamentals of a Fee-based Charitable Program

If an organization is operating a program and charging a fee, one would expect the number of people who could benefit from the provision of the good or service has been estimated along with a calculation of the cost to provide it. A fee struc-

ture is established from these figures with the intention to serve as many of the group as possible and generally cover the cost of the program over a fiscal period.

This can be a complicated revenue generation activity, certainly more complex than a fully funded program where no fees are charged. Establishing a fee structure introduces variables such as estimation of service usage, a more elaborate calculation of costs, and the element of potential activity shortfalls or losses.

There can also be the perception that cost calculation should only include direct costs, not indirect ones such as an allocation for management and administrative expenses*. Most likely this derives from the propensity of some grantors to provide funds for direct program expenses only, excluding any allocation for administration.

** It is important to understand how CRA specifically differentiates between expenditures on management and administration, on charitable programs, and on fundraising. Of particular note is the common misperception that any type of compensation is automatically considered management and administration.*

An example - ABC Charity

ABC Charity has identified a community need for an affordable transportation service for an estimated 500 people. To meet its charitable purposes, it establishes a fee-for-service transportation program. It is estimated it would cost \$50,000 to provide the service for 500 people. To be considered altruistic and have public benefit, their goal will be to make the service as affordable and accessible as possible i.e. if they could afford it, they would offer the service free of charge.

In determining the fee structure they would not consider prices charged in the marketplace by other transportation providers including other charities who may operate a similar service in another community. They would only consider how much they will need to charge to ensure the activity is operated in a cost-defraying manner. Aside from the direct costs to operate the service, a reasonable allocation of administration expenses should also be considered in expense calculations. ABC Charity determines they will have to charge \$100 per person to cover the costs of the program.

Unlike fully funded program delivery where normal practice dictates every dollar is spent by a stipulated end date, it would be unreasonable to expect this activity to show a zero dollar balance at the end of every accounting period. A profit or surplus should be fine as long as it is incidental, and in my view makes fiscal sense to plan for such a surplus to guard against losses due to unforeseen changes in revenues or expenses.

If costs were lower or revenues were higher than forecast over a fiscal period, then the expectation would be to take this into consideration when determining service fees for the next fiscal period to ensure it is cost-defraying. In ABC Charity's case, if costs turned out to be \$40,000 instead of \$50,000 then the organization should give reasonable consideration to lowering their cost estimate for the next year and change their fee structure accordingly e.g. from \$100 to \$80.

If the activity generated a more than incidental surplus year after year because expenses were consistently being overestimated, this likely puts it offside of CRA policy as the altruistic nature and public benefit of the service would be questioned. This makes sense as the charity would be charging a higher fee than what is needed to operate the activity thus potentially denying their service to a segment of the public who could not afford the higher fee, in this case \$100 versus \$80. In other words, charitable outcomes would be compromised by the higher fee.

If planned and managed properly there is no reason why this type of program cannot be sustainable and grow to meet the needs of the community. It is intended to be reliant on revenues from user fees, operate on an incidental profit basis, and not negatively impact overall administrative resources. The only variable in the program's scope and size would be the demographics of the community it seeks to serve.

An Imagine Canada resource indicates activities that charge for a 'good' service which benefits participants or the community at large and makes modest profits is often referred to as SE and suggests these types of activities are best housed in a for-profit business entity. It is unclear what is meant by modest profits, it could be interpreted as a surplus that occurs incidentally from a fee-based activity. If so, then the activity potentially could be housed in a registered charity.

Fee-based charitable programs as a business or in the marketplace

One SE resource lists "market improvement" as a SE motivation that meets a "need which is unmet within the traditional

marketplace”. It is not clear whether improving the market opens the door to profit generation but I would assume so given the reference to ‘market’.

In my view, it is obvious a charitable program that charges a fee, or rather the identified gap in service within a community that initiates the program, would not be a good business opportunity. Provision of the service should be viewed as serving a need, as noted above, more so than meeting a market demand. The fact there is not a private provider i.e. it is ‘unmet within the traditional marketplace’ is confirmation that a business or for-profit model would likely not succeed.

I believe fee-based charitable programs can only be profitable when potential funding, donations or subsidies are added into the equation. This is where some self-identified SEs appear to operate in the belief switching intent from cost-defraying to for-profit is a good strategy as long as the fee structure uses the marketplace as its guide.

Looking at the transportation example, instead of a fee structure that would look to cover the costs of the service, the charity would first set its pricing based on fees charged by other providers in the marketplace. Marketplace fees could be established from:

- fees charged by private service providers
- fees charged by charities that run similar services in other communities
- fees the charity themselves have charged in the past

If they are then able to secure funding and/or donations to cover some of the costs of the service, they most likely would show a surplus that can be used to fund other programs.

For example, in its second year of operating the transportation service ABC Charity is able to secure a \$25,000 government grant but does not lower their pricing as they have established \$100 as their ‘marketplace’ fee from the previous year. They would likely show a substantial profit to use on other programs.

What gets lost in this type of thinking is that any fee charged, regardless of whether it is just below market rates or deeply discounted, potentially excludes people from their service which bring into question its benefit to the public and the organization’s charitable purposes. To eliminate any sense that the program has not lost the two essential characteristics of charity - altruism and public benefit - they would lower their fees to account for the lower expenses.

Also not realized is adding a for-profit motive into the mix, the so-called double bottom line, can clash with their charitable motives on another front. If the transportation service is relied upon to produce a \$25,000 surplus every year to fund other programs then the potential diminishment of charitable outcomes is justified in meeting its other bottom line. For example, they may choose to operate the transportation service in a less accessible manner (e.g. less hours per day) if they needed to save costs to keep their profits at the \$25,000 level.

In my opinion, this is a clear example of a for-profit motive conflicting with a charitable (or social or community) outcome. There is no grey area; it is either for-profit or it is charitable. A fee-based program is charitable because it defrays costs, or put another way, defraying costs makes it charitable, not defraying costs limits or lowers social impact. This should counter any perceptions that profit needs to be artificially avoided to meet CRA tax-influenced regulations.

This particular scenario appears to be guarded against as CRA makes it clear if government pays a charity to deliver a service on its behalf, it needs to be considered in its fee structure. I believe the same thinking should apply if ABC Charity received a foundation grant or donations (both cash and in-kind) specifically for the service. All types of gifts and grants should be treated the same as government funding - public money that is helping the charity deliver a service on the public’s behalf.

I would also extend this to scenarios where government subsidies are made available to enable purchase of essential goods or services in the marketplace. For example, if a \$100 coupon for transportation was available for ABC Charity’s clients, there would not be a need for them to seek other public funding to deliver their service as their client’s transportation needs have already been accommodated for with public funds. One could see how a charity would justify attempting to profit from this as it appears there is a market for a \$100 per person transportation service; if ABC Charity feels the \$100 subsidy presents an opportunity they could profit from, they could establish a separate business entity to deliver the service (unrelated businesses will be examined in Part 9).

Other risks and consequences

Some may justify not adjusting their fees in these situations as surpluses are viewed as 'social' profits to be used on other programs and services that forward their mission. I think it is clear they do so at the risk of being offside of CRA policy and, maybe not as clear, supporter goodwill, relations with other charities, and overall community impact.

If ABC Charity chooses to profit from the transportation service, the question arises of why they are receiving funding or soliciting donations if they are not going to use it to operate their service in a cost-defraying manner, or in other words, if it is not required to operate the program. For all intents and purposes they would appear to be flowing funding/donations through the transportation service to other programs.

This question could be asked by a funder or a donor. One would assume their motivation is to support the transportation service and said support was likely solicited by the charity to that effect with the expectation the service will be provided charitably - as affordable and accessible as possible. By using the funding/donations in a manner that is different from that intention, ABC Charity is not respecting funder/donor wishes and risks losing their support.

This question could also be asked by other charities that could benefit from the same funding/donations creating a sense of unfairness and inequity. This could have a harmful effect on relationships with these organizations where the sharing of information and ideas is a usual and encouraged practice.

The effectiveness of funding programs can also be negatively affected in this scenario. If ABC Charity can operate their program without some or the entire \$25,000 grant, would it not be better if any unnecessary funds were used by another group in a different community so they could launch or enhance their own transportation service? If the funder's goal is to assist in the provision of affordable and accessible transportation equitably or proportionally throughout a specific region, this would be inhibited by ABC Charity's actions. Although ABC Charity is ultimately putting the funds to good use it does so at the cost of the effectiveness of the funding program and overall community impact.

Does SE equal for-profit?

Although some self-identified SEs appear to take this position, it is not entirely evident that SE necessarily dictates applying or adding a for-profit motive. The variable of charging program fees and the ambiguity of SE combine to bring in other interpretations.

SE could be the dynamic of simply charging a fee for a charitable program as opposed to offering it for free (or 'charitably' in SE narrative). Given the lack of content in SE resources about fee-based charitable programs, this still can be perceived as getting into the apparent grey area of commercialization where opportunities to generate unrestricted surpluses are acceptable if presented.

SE could also mean generating profits or surpluses after direct costs are covered to go towards general administrative expenses, possibly another version of 'profits are reinvested into the organization'. This could also be a by-product from the direct program costs-only mentality of funders mentioned earlier. This can lead to an even more compelling case for intentionally generating profits as:

- likely a specific allocation for administrative expenses has not been calculated as the need to fund administrative (or general or core) expenses for most organizations is seemingly unlimited
- if it is okay to earn surpluses to apply towards administrative expenses, it must be okay to apply surpluses to other programs if general administration costs are already fully funded

Another scenario - leveraging Infrastructure

Another SE idea is generating 'social' profits by leveraging program infrastructure to produce and sell goods outside of their charitable sphere i.e. in the marketplace and in competition with other service providers. For example, along with providing the service to their clients in an identified community, ABC Charity will also provide a transportation service to the general public. Maybe not the exact same service but something where they can take advantage of the program framework already in place and paid for with social capital (funding and donations). This would give them a competitive edge over for-profit providers who have to charge enough to cover both the fixed and variable costs of their service. In order to appear to not be undercutting private service providers' pricing, they will charge similar (marketplace) rates.

This for-profit or business arm likely brings into question whether ABC's Charity's purposes are exclusively charitable as there would be no public benefit associated with the for-profit service. Aside from the fact they intend to profit from the activity, it also should be obvious the for-profit service arm would not meet the criteria of being 'for the benefit of the public or a sufficient segment of the public' as they have already identified that an affordable and accessible transportation system was lacking for a segment of the community. ABC Charity's for-profit service, on its own, probably would not pass the public benefit test, nor would it pass simply because profits from it will be used to forward their mission (the 'destination of profits' test). They may be able to operate this kind of activity as a related business under the **A use of excess capacity** condition in CRA policy but likely not on a continual basis where it would make sense to seek investment capital such as a loan, a key variable in SE narrative. Related business activity will be examined in more detail in Part 8.

In practical terms, this scenario would also bring into question any funding ABC Charity may be receiving and why they need it. If they are able to operate the charitable transportation service and also a for-profit arm, then it would appear they are expending some of their social capital on an activity (the for-profit transportation service) that has no public benefit. Again, funders, donors and other charities may react negatively if it appears ABC Charity is not using their funding/donations as intended.

Even if ABC Charity plans to finance and operate the for-profit arm separately from the charitable program, this still puts social capital at risk as they would be liable for any potential losses from the business. In order to avoid this and possible compliance issues, ABC Charity could set up the business in a separate corporate entity which then could make distributions and/or donations to the charity.

Interestingly enough, this type of activity is mentioned in SE resources as 'mission drift', where a mission-based SE has drifted to become more of a generator of 'social' profit. It is not clear though whether the potential for the misuse of social capital or the diminishment of charitable outcomes is fully recognized.

Social Enterprise as a Cause

This scenario brings to the forefront a sense that SE is a cause; where 'business for good' is seen as deserving of tax exempt treatment and complaints of unfair competition are rendered immaterial so long as a SE's pricing is similar to others in the marketplace. In my view, this makes a number of dubious presumptions, most notably that if a business is not 'good' it is bad or at least not contributing anything socially.

There seems to be a lack of appreciation by SE promoters of how business and the marketplace works. Businesses risk investment capital and price their goods and services against their competition. The majority of businesses likely do not make much, if any, profit and if they do, usually have to put it back into their business to stay competitive. If one company is profitable, you can be sure that it will not be as profitable for long as others will quickly emulate their business model.

Another presumption is businesses exist solely to maximize profits for shareholders excluding the many businesses run by individuals who are simply trying to make a living and operate as a formal corporate entity for business and tax purposes. Another is the belief that offering another good or service option in the marketplace is acceptable so long as pricing is competitive which reveals a lack of recognition that any new entry into the market potentially takes away business from current providers regardless of pricing structure.

In my view, a SE which can compete only because it is artificially supported with social capital unavailable to others in the same marketplace is inherently unfair. Even if only one tax-paying entity is affected by ABC Charity's actions, there would be a legitimate complaint of unfair competition as their ability to earn would be infringed upon.

I would also question whether ABC Charity is closing the doors on opportunities for support from businesses and individuals who would consider ABC Charity to be their competition. From a fundraising perspective, private service providers would be a natural fit to support a charitable transportation service, especially with in-kind donations. I have suggested that formal partnerships with for-profit entities to deliver charitable programs as an intermediary could be very cost-effective reducing the need for traditional grants. I believe it makes strategic sense to work with, rather than against, others in the community.

Perhaps this feeling is because of another cause-themed SE narrative that the 'market has failed' to provide an affordable and accessible transportation service in the community. The reason for failure being for-profit providers are only motivated to

maximize shareholder returns thus ignore the needs of those who do not have the means to pay for their market-rate priced services. This would also instill a sense of a higher placing in the community entitling SE to the different tax designation and unrestricted entry into the marketplace.

Again, I feel the realities of operating a business are not appreciated. If they were, the market would be described as indifferent rather than a contributor to social issues and assumptions that private providers would not be interested in supporting community initiatives would not be made.

I believe there are many businesses, particularly smaller ones or ones outside of major urban centres that already make an impact in their communities. It may not formally be reflected as a sponsorship or a donation, or show up on a corporate agenda, but contributions by a company or its owners would certainly be recognized in the communities they serve and likely the community responds in kind by supporting their business. Allowing competition that is not on an equal playing field would be particularly unfair for these businesses.

This seems to be overlooked by SE promoters who focus on 'big business' - corporations who have no connection or engagement on a local level as production, shareholders, and corporate offices are located outside of the community. While I believe there are positive aspects to community-based business ownership, management and production, this should be encouraged by more appropriate and effective means such as targeted financing, economic development funding, and tax incentives rather than changes to tax designations or use of social capital. This will be examined further in Part 6.

Part 6: Activities of Registered Charities - Community Economic Development

Overview

In 2012, CRA released guidance on **Community Economic Development Activities and Charitable Registration** which replaced its **Registered Charities: Community Economic Development Programs** guidance issued in 1999. It provides the parameters in which Community Economic Development (CED) activities which “generally involve improving economic opportunities and social conditions of an identified community” will be considered charitable. Besides geographically, ‘community’ can also mean “an identified group of eligible beneficiaries who share a common characteristic that results in an economic disadvantage”. It lists five areas CED generally falls into:

- activities that relieve unemployment
- grants and loans
- program-related investments
- social businesses for individuals with disabilities
- community land trusts

The guide puts clarity on any regulatory ambiguities from the original guide and, in my opinion, creates a very enabling environment in which to improve communities through charitable CED activity.

In contrast, the reaction from the SE community seems to be underwhelming despite the guidance’s focus on oft-cited SE themes such as the employability of marginalized people, ‘social’ or ‘impact’ investment capital (traditional business financing directed to a social cause), and a focus of social and economic resources to high need communities. Another reaction has been a lack of differentiation between the guidance and the rules for related business. I would attribute both of these to the common misunderstandings of charity and charitable activities by SE promoters mentioned in Part 4.

Employment-based Charitable Programs

Registered charities can operate two types of employment-themed charitable activities which can forward charitable missions and sell goods and services produced from the programs in the marketplace. **Social businesses for individuals with disabilities (SBFIDs)** seek to provide permanent employment opportunities for persons with disabilities. **On-the-job training (OTJT)** provides on-the-job training in vocational or work skills that enhances an individual’s employability.

In CRA’s words, SBFIDs “must focus on helping eligible beneficiaries and not on making a profit.” and the focus for OTJT “must be to further a charitable purpose, not to generate revenue.” CRA’s policy **What is a Related Business?** is referenced for both activities for clarity on what would or would not be permitted in the delivery of these programs.

Perhaps even more so than a fee-based charitable program, this can be perceived as getting into a grey area of commercialization as goods and services produced in these two programs can be sold in the marketplace seemingly without restriction and in competition with private business. A SBFID can sell products made by its clients at any price and in any marketplace (even in its own store); a OTJT activity like a café that provides training for the service industry can be set up anywhere and set its pricing at marketplace levels. One of the activities even has ‘business’ in its name and OTJT is referred to as a “training business” by CRA (wording they may want to change to avoid confusion).

Despite this, it is clear in CRA policy that operating these activities with anything other than a focus on program outcomes, ergo charitable, likely puts them offside of CRA policy. If the activities are deemed to be a business rather than charitable then the question arises of whether it is a related or unrelated business, the latter being the probable answer which is not permitted. As was referenced in Part 2, the employment variable and/or the marketplace sale of goods do not necessarily create an automatic ‘connection’ to operate these activities as a related business (incidental business).

An example - DEF Charity

In order to offer a permanent employment opportunity for persons with disabilities, DEF Charity launches a SBFID that will produce woodworking products. To meet its charitable purposes, DEF Charity will try to employ as many eligible persons as possible in an inclusive manner meaning participants will be treated equally regardless of skill or capability. They would not,

for example, give more working time to those who show the greatest productivity. This action would bring into question the altruistic nature and public benefit of the activity as it would exclude a part of the public from receiving the full benefit of the program.

They will receive funding to pay compensation to the program participants and program supervisors. They will cover other program expenses such as production materials and an allocation for administrative expenses from other sources of revenue including the marketplace sale of the products produced in the course of operating the program. In the first year, they received \$100,000 in funding for compensation and had \$50,000 in product sales for a total of \$150,000 in program revenue. The program had five participants and \$150,000 in expenses.

If the program generates a more than incidental amount of revenue above expenses then the question arises of whether the activity is focused on profit rather than its beneficiaries. One legal opinion advises that SBFIDs and OTJT can intentionally generate surpluses so long as the activity stays program focused. For example, if DEF Charity plans to expand their activity to employ more clients and needs an investment of capital to do so, they can raise the necessary funds by trying to generate surpluses. At least one SE resource references this opinion to indicate that SBFIDs and OTJT can be for-profit but does not include the context in which profit can be earned thus gives the impression of being unrestricted.

Employment-based charitable programs as a business?

If DEF Charity's SBFID is focused on profit rather than program outcomes, this likely sees a more than incidental profit being realized and raises a few questions:

Does DEF Charity need the full amount of its funding for compensation if it appears it can be sustainably run with a lower amount?

In its efforts to meet revenue goals, is the inclusiveness of the SBFID being comprised?

Does DEF Charity have the capacity to increase the number of program participants from five?

Should DEF pay more compensation to its clients from the activity's surpluses?

Similar to fee-based charitable programs operating with a for-profit motive, this scenario brings the same risks and consequences such as misuse of social capital, the potential for diminishment of social outcomes, funder/donor wishes not being respected, complaints of inequitable distribution of funding by other charities, and a negative effect on funders' overall community impact.

Operating a SBFID with a profit focus seems to be justified by SE promoters because they either feel the new CED guidance falls short of allowing SBFIDs and OTJT to earn unrestricted profits or through the mistaken belief that SBFIDs and OTJT are, or should be, related businesses thus free of any restrictions. In my judgement, a lack of understanding of CRA policy and an even larger sense of 'doing good' contribute to this thinking.

Could DEF Charity leverage its infrastructure to produce woodworking products for marketplace sale outside of the scope of the charitable program? It is unlikely they could without using charitable resources in a manner that would compromise public benefit and not on a continual basis. This scenario will be examined in more detail in Part 8.

Also similar to fee-based charitable programs, it is not entirely evident that SE necessarily dictates applying or adding a for-profit motive. SE could be the dynamic of selling products and services produced in the charitable program as opposed to viewing it as a make-work type project where products do not reach the marketplace. Given the lack of content on employment-based charitable programs in SE resources, this also can be perceived as getting into the apparent grey area of commercialization.

Social Purpose Business

One of the most common SE ideas is to view this scenario as a business opportunity - to produce and sell a product in the marketplace. The double bottom line in this case is the potential for surpluses for distribution to a charitable/social purpose (or to shareholders if it is a company) and the employment of marginalized persons which lowers their reliance on unsustainable social handouts. It also provides a potential opportunity for capital investment from socially conscious investors. The

productivity of persons with disabilities and expenses associated with supervision are perceived as a hindrance to business development; any funding the SE receives for compensation is viewed as closing the capacity or competition gap between it and private businesses who only hire fully capable employees. In SE resources, this type of activity is usually referred to as a Social Purpose Business.

Noble intentions aside, it seems like a risky undertaking where financial goals or, more likely, financial realities could conflict with inclusiveness. By necessity, more productive employees and those with greater flexibility (i.e. able to logistically work more hours) would likely be given priority over less capable or less flexible employees. If the activity is relied upon to fund other programs, this would also justify choosing financial returns over social ones. The possibility of compromised social outcomes in a Social Purpose Business is mentioned in SE resources but usually only in the context of potential SE investors' needing a reasonable financial return on their capital investment.

As the business has a double bottom line, accountability for social outcomes might not apply meaning social capital would be at risk. Instead of being used exclusively on compensation, funding or donations could be used on tools for revenue generation such as marketing campaigns or equipment purchase which would be viewed as equally important to the viability of the SE as the employment aspect. I believe it would become clear to the operators of a Social Purpose Business there is only one true bottom line - the financial one. If the SE is losing money it cannot sustain itself and would have to close. On the other hand, social goals would have the flexibility to be lowered in order to make ends meet. Put another way, there is a hard stop financially but not socially.

In my opinion, this is another example of for-profit motive conflicting with charitable outcomes with no grey area in between. This should not be viewed as a negative reflection on the intentions of the SE operators but simply recognition that in any business venture, the financial state of affairs are black and white and ultimately take priority over other agendas.

From a strategic viewpoint, it simply does not make good business sense to compete against others in the marketplace using a less capable workforce. Nor does it make sense to use funding and donations to artificially close a competition gap that would be difficult to measure and easily manipulated if financial goals or realities warrant it. Stringent regulations, likely greater than CRA's, would have to be introduced in order to ensure funding is being used appropriately. An employment-based charitable program seems to be a much better choice as its operation and design reflect a realistic assessment of the capabilities (i.e. the employability) of persons with disabilities or other marginalized persons.

I believe these realities are somewhat distorted by cause-themed SE narrative that suggests the market has failed to provide or has put up barriers to employment for marginalized persons, and there is a substantial amount of capital available for 'social' investment opportunities like a Social Purpose Business (this will be covered in Part 10). I would point out again that the market should be viewed as indifferent rather than failing and allowing unrestricted entry into the competitive marketplace by entities propped up by social capital would be unfair.

I would also point out again that working with, rather than against, other organizations in the community would be more impactful. A partnership with a for-profit entity provides an option for a charity to meet its employment-themed social goals while reducing or eliminating the need for third party funding. This could broaden the concept of organizations operating employment-based programs participating in government procurement contract bidding processes, in itself an avenue to reduce funding needs, as businesses with a formal charity partner could be included.

There also appears to be a viewpoint amongst some SE promoters that people who work in the social sector do not get paid enough due in part to dated perceptions and unrealistic expectations by funders and donors. Operating outside of the sector as a private, for-profit entity offers the opportunity to "do well while doing good"; to earn a higher income while making a social impact in the community. In a broader view, higher salaries also would potentially entice a more talented and impactful workforce to the arena of social program delivery that is seemingly hampered by low compensation.

As noted above, this type of business is likely going to have a difficult time succeeding. I would suggest to individuals or groups to start a business and create a formal partnership with a registered charity that would see the charity's clients providing labour for the business in return for a negotiated fee. This would eliminate the natural conflict between financial and social outcomes as business management would focus on the former and the charity would be responsible for latter. Tax incentives and targeted funding for businesses who take on a charitable partner could make this an attractive commercial undertaking for entrepreneurs of any ilk, not just socially motivated ones.

Other Charitable CED Activities

Other charitable CED activities can broaden social impact by opening the door to investment capital and to employment and entrepreneurship opportunities seemingly in the way the SE community envisions:

- (1) **Individual Development Accounts (IDAs)** help relieve unemployment of the poor, advance education by providing funds for employment-related training, or relieve employment-related conditions associated with disability. Loans, micro-loans and loan guarantees can also accomplish this along with assisting entrepreneurs and worker cooperatives.
- (2) A charity can provide investment capital as a **Program Related Investment (PRI)** in the form of a loan, loan guarantee, share purchase or a land or building lease. This would seem to be a great fit for a fee-based charitable program that potentially only requires investment in infrastructure as the program could be sustained by user fees.

Surprisingly, the SE community seems to be unaware of IDAs and loan programs, and PRIs, if acknowledged, are viewed as not going far enough as they can only further charitable objectives thus are limited to qualified donees like registered charities (other organizations that identify themselves as having public benefit missions or agendas such as NPOs and for-profit entities are not eligible). I would suggest the SE perception of 'charity', the registered charity/NPO dynamic covered in Part 2, and an overly optimistic outlook on operating a business contribute to this perspective.

Further to the last point, there is not an external regulatory accountability mechanism in place that ensures for-profit entities are meeting their stated social goals or purposes. Similar to a Social Purpose Business, any for-profit entity with public benefit as a mission or part of their agenda will ultimately be guided financially. This means the impact of a PRI may be lessened if the beneficiary has to close or sacrifice their social outcomes to stay competitive. This does not mean the SE has failed or should bring the SE's intentions into question, it is simply the reality of the business world.

CED activities in areas of social and economic deprivation

In CRA's words "CED activities may be charitable if they improve socio-economic conditions for the public benefit in an area of social and economic deprivation." Characteristics such as high unemployment, crime, health issues and children at risk are examined to determine if an area fits this classification. Activities such as ensuring a reasonable level of health care or preventing unemployment through training in these areas may be acceptable if they are deemed charitable.

Although not clearly indicated as an acceptable employment-based program like a SBFID or OTJT, providing employment in a socially and economically deprived area (SEDA) may also be a possibility. CRA states that "the courts have not recognized 'providing employment,' or 'helping people find employment' as charitable purposes in and of themselves when the beneficiary group is the general public." But providing employment could be an acceptable charitable activity if it benefits "the community in a way the law regards as charitable" which, according to CRA, is the charitable purpose that improving conditions in a SEDA falls under. This would require clarity from CRA or legal opinion but a charitable program providing employment to persons within a SEDA could be a possibility because the beneficiary group would not be classified as 'the general public'. If it is a possibility, my guess would be it would operate in a manner similar to an SBFID or OTJT with a focus on program outcomes and inclusiveness.

The concept of charitable activities for SEDAs is surprisingly unexplored by the SE community despite being very much in line with narrative that SE operates in, or directs its impacts to, communities in need or a marginalized community such as First Nations. Again, I would speculate the term charity, and the connotation of unsustainability that goes with it, is painted on any charitable program option.

Economic activity as a public benefit?/Collateral social impact

In keeping with its apparent theme of business and sustainability, SE narrative seems to take the concept of enabling vulnerable communities further under the premise economic activity taking place in a deprived area or operated by a marginalized group has social benefits which are equal to, or perhaps greater than, those of a charitable program. Greater, in a SE perspective, as economic activity, unlike an unsustainable charity handouts, would be market-driven, open for capital investment, less reliant on funding, and provide stable employment.

This means the operation of business in and of itself has public benefit regardless of its products or who it employs. This differs from previously mentioned SE ideas where the product or service was considered essential or it improved the employ-

ability of marginalized persons. A business that produces any type of product and/or employs fully capable workers can describe themselves as a SE depending on where it operates or who it is owned by.

The breadth of potential SE activities, ones that appear to be at opposite ends of the spectrum, or even at odds, is best exemplified by this model. Casinos and environmentally unfriendly energy companies can seemingly be called SE as easily as the activities of charities whose missions are to alleviate the social or environmental issues these businesses potentially create. In what appears to be a contradiction, business can deliver social impact despite its propensity to 'fail' on the social front.

As promotion of economic activity is strongly supported by different levels of government, this can give the appearance of bridging charity and business creating a cross-governmental morass at the federal and provincial levels. Provinces and the federal government appear to be "on board" according to one SE promoter as economic development and human resource agencies acknowledge or support SE in some respect; it is now up to CRA to update their policies to reflect the apparent acceptance of SE by government. Government support of renewable energy initiatives can add to this perception.

In my opinion, this is also contributed to by the 'SE as a cause' factor. In reviewing SE content from various government agencies, 'non-profit' business seems to be promoted, at least on the theoretical level, with the same enthusiasm found in SE narrative leading to its addition to government social change agendas. But rather than defining or having any kind of ownership of the SE concept, these agencies tend to simply reference externally developed SE definitions and descriptions. One is left with the impression these agencies likely do not understand the fundamental differences between commercial businesses, NPOs and registered charities. This is not surprising given it is not in their mandates to ensure organizations comply with their respective incorporation legislation and regulations. This can lead to sentiments by these agencies that reinforce misperceptions about CRA policy. In one instance, NPOs and registered charities were publicly encouraged to ignore CRA policy seemingly in the belief the policies are in place only to protect tax revenues.

It is also important to recognize these agencies do not have accountability mechanisms in place to ensure the SEs they support are stewarding social capital for public benefit. Nor are they responsible for the fairness of the tax system. The only agency that is accountable for tax designations, for social capital stewardship though the compliance of registered charities, and is the de facto regulator of registered charities, is CRA. While other agencies may support SE, their interest is only in one of the 'blended values', not in the potential conflict that may arise in seeking them.

Similarly, some corporations also seem to be on board with SE through social impact funding, in itself a very broad and ambiguous concept. Even more so than government support, external accountability for social outcomes by SEs would be minimal or non-existent.

I question whether funding from government and corporations towards business development under the guise of collateral public benefit would be as impactful due to its use on conflicting, for-profit activity rather than on the many charitable program options. The strategic challenge of assuring a business in and of itself is charitable is best examined in an example.

An Example - GHI Charity

GHI Charity starts a business in an area that has seen an economic downturn leading to high unemployment. The hope is to try to reinvigorate the community through economic activity which will provide potential jobs and generate revenue from outside the community through the sale of its products. Any profits from the business will be 'reinvested into the charity' to help further its mission.

The business will not be offering any products or services that would be deemed essential. Nor will it necessarily employ specific groups in the community or attempt to fill all positions from within the community; it will hire the best available people for its operations. The charity will seek donations and funding to cover business expenditures increasing its viability.

The double bottom line for this SE would be the financial one and the social impact of the existence of the business. Different than other SE ideas, in this case the two bottom lines could be viewed as one in the same - as long as the business is operating there is social impact.

From my perspective, again noble intentions aside, this would seem to be a risky use of social capital (along with obvious financial risk if any financing was secured). By necessity, the business may have to hire employees from outside of the com-

munity or invest its capital in resources that may have no direct affect on the community e.g. supplies and materials from other regions or contracted out services like marketing to firms located elsewhere.

There would appear to again be a conflict between financial and social outcomes and even less accountability for the latter as the operation of the business itself would ostensibly be proof of social impact. Perhaps more so than any other SE idea, I believe this one presents a scenario where social capital is at its greatest risk; where altruism and public benefit could be negligible simply from the reality of operating a business in a difficult economic environment. From a social impact perspective, there would be no hard stop or potentially even a starting point as the business may need to reach financial sustainability before it can incorporate socially impactful elements such as use of local employees or supplies.

Funders and donors may be less willing to support the initiative if their social capital is not guaranteed to be directed to the community. GHI Charity would have to be careful to make sure funding and donations are not solicited in a manner that is construed as deceptive.

It is also notable the activity is designed to potentially rely on funding and/or donations to be feasible which would appear to be in contradiction of one of the key SE themes of moving away from unsustainable funding programs that do not create fundamental change. If the business cannot be maintained from the sale of its products alone then it would appear to not be providing community impact any different from what traditional charity or government social program funding produce. Even if GHI Charity's plan is to operate the business without using any grants or donations, it still runs the risk of being liable for any potential business losses which could take away use of social capital on other programs.

The only way to operate this type of activity to avoid unnecessary risk of social capital and the conflict of interest between social impact and for-profit motives would be to operate as a separate business entity. In order to take advantage of any funder/donor interest in the undertaking the entity could create a formal partnership with GHI Charity to deliver an employment-themed charitable program. This would ensure social capital is used effectively and funder/donor wishes for direct community impact would be met.

The business side of this initiative would also benefit from having two independent entities. A separate for-profit entity would be able to focus exclusively on its operations without trying to meet a stated or expected obligation to keep its suppliers and employees local. This would present a more attractive business plan for potential financing and funding from economic development agencies.

Business investment in a deprived area

In my view, launching a business in a deprived area is potentially the most impactful and the most unambiguous SE concept, one where business and charity can share the same social purposes and benefit from each other without conflict of interest. It would also afford an opportunity for support by socially conscious investors in a manner that best reflects how capital investment is intended to work which could be enhanced through potential funding opportunities, tax incentives, and charity programs and partnerships.

While I believe operating a business in a deprived area is risky even with a social element attached to it, there is merit in trying to restore old industry or establish new ones in a formally classified deprived area. Increased employment and economic spinoffs would certainly have impact in the community, just not in the context where it makes sense to classify for-profit activity on its own as charitable i.e. beneficial to the public.

As alluded to in Part 5, business activity in specific regions or to a particular community can be encouraged through means to augment potential capital investment. For example, SEDA business-specific economic development funds and investment tax incentives could be introduced. This would enable an individual or group to make their 'social' capital investment at a risk level lower than one would normally expect.

Risk could be lowered further by directing some of their capital in the form of a charitable donation to establish a registered charity with a SEDA-themed mission. Direct impact to the community could be concretely established through a formal partnership with the charity to deliver an employment-themed charitable program as the beneficiaries would be from the area.* From a marketing standpoint, this would allow the business to confidently publicize its social impact to potential consumers or other investors. A formal charity partnership could also trigger tax incentives and open up further SEDA specific funding. Assistance with employee training by the charity under certain circumstances could also benefit the business.

Another area which a SEDA-themed charity could explore to potentially support a SEDA business are **Community economic development activities that promote commerce and industry**. In CRA's words "charities may conduct CED activities to promote a particular industry or trade such as agriculture, horticulture, or craftsmanship" as long as they are for the public benefit. This could include promoting greater efficiencies within an industry such as conducting research into a community's socio-economic profile, promotion of industry-wide standards and excellence, and the development of new scientific and technological knowledge related to that industry.

For obvious reasons, ensuring a public benefit versus private one in this particular area of policy is emphasized by CRA but similar to an employment-themed charity program, if the community where the activity takes place is a SEDA that may hold some significance. This would also require clarity from CRA or legal opinion but an activity that promotes commerce and industry in a manner which would normally be viewed as conferring an unacceptable private benefit could be viewed as charitable if it improves the socio-economic conditions for the public benefit in a SEDA.

** As noted earlier, this concept is not mentioned specifically in CRA policy. Organizations would need to ensure it is compliant.*

Return on investment

A SEDA business would also let investment capital function in its conventional manner by offering a return to investors that reflects the risk they assume with their investment. This is in spite of the charitable alternative appearing to be the more appropriate option for 'social' investors.

On the surface, the idea of operating a SEDA business in a charitable entity seems to make sense as any profits would be 'reinvested into the charity's mission'. Similarly, the idea of investors benefiting from charitable tax receipts for their donation in support of the business activity also seems like a logical representation of their 'social' investment. According to SE narrative, the social investor's goal is not to necessarily benefit from traditional shareholder distributions so it seems fitting that ownership of the business is by a charity where tax deductions for investors replace dividend distribution.

I believe the likelihood that a SEDA business will reach a point where it is producing significant profit makes this line of thinking somewhat moot. Nor does it alleviate the potential for conflict for social outcomes outlined earlier. If a private SEDA business happens to make a profit then it is reasonable for it to distribute dividends to its shareholders free of concern profits are being unfairly removed out of the community or that it is taking advantage of any government supported SEDA business incentives and funding. After all, the investors are the ones who are risking their capital.

If investors are happy with returns being in social form rather than financial, the business could create a cause-related marketing type arrangement that would see some or all of its profits donated to the charity. This could also further cement its association with the community to the benefit of its marketing campaigns.

The concept of receiving tax receipts instead of dividends in return for directing funds towards SE-themed purposes like business activity should not necessarily be discounted. There may be options for socially conscious investors to financially support a SEDA via the charity route where an appropriate and practical balance of public and private (i.e. investor) benefit takes place. This will be discussed in Part 10 .

Part 7: **Activities of Registered Charities - Fundraising**

Overview

In 2009, CRA released its guidance for **Fundraising by Registered Charities** (Fundraising guidance) which provided clarity on CRA's position on fundraising. While not recognized as a charitable purpose or activity, CRA acknowledges many organizations rely on fundraising in order to fund their programs and services; fundraising is allowed as long as it is done within the legal parameters set out by CRA. The guidance, which was revised and rereleased in 2012, was the result of consultations with charity sector stakeholders and provides clearer boundaries on any perceived ambiguities for fundraising activity.

In general terms, the guidance reflects an expectation that if support is solicited for a social cause then a majority of the funds or in-kind support received should go towards that cause e.g. to fund medical research, to feed the hungry, to enhance post secondary education, etc. Maybe not as clear to those outside of the sector is 'the cause' would also include salaries of employees involved with charitable program delivery and an allocation for administration expenses and compensation paid to management.

If more money from solicitation efforts ends up in the hands of organizations or individuals who are not the cause, I believe it is reasonable to ask at what point does a donation or show of support cease to be one if the cause (public benefit) is not the primary beneficiary of said support. In CRA's view, it becomes a question of whether private benefit has become more dominant than public benefit.

Conversely, SE narrative seems to promote fundraising, along with retail activity which relies on consumer goodwill, outside the scope of CRA's Fundraising guidance which likely leads to an increase in competition for fundraising dollars, potential risk of social capital, and lower overall social impact.

The Sale of Goods and Services for Fundraising Purposes

Of the various types of fundraising initiatives undertaken by charities, this activity appears to capture the most attention in SE resources as it places goods and services in the marketplace in the hope potential surpluses can be achieved to put towards social programs. Girl Guide cookie sales, lotteries and raffles, and golf tournaments are common examples.

Despite the appearance of being a business, registered charities who operate these activities must abide by the Fundraising guidance. This generally means it is expected the majority of revenues from the sale of these goods and services will go to the cause, the exception being gaming activities (lotteries, raffles and bingos) where regulations at provincial levels are taken into consideration.

An Example - JKL Charity

JKL Charity has a bake sale that brings in \$100 of revenue. The expectation is more than \$50 will go towards their cause while less than \$50 will be spent on non-cause, private benefit expenses such as baking supplies, advertisement, and the salaries of any employees who organize and operate the bake sale.

I believe this makes sense as it is hard to deny that a purchaser's incentive to buy a baked good is not influenced by the connection to JKL Charity's cause. In other words, they would not necessarily buy the product on its own without the direct charitable link. The purchase of the good is viewed the same as a donation - it is motivated not by the demand for the baked good but rather by a desire to forward a charity's mission hence its similar treatment by CRA and inclusion in the Fundraising guidance. Accordingly, the bake sale is viewed as a solicitation for donations, not as a business.

I believe CRA accurately captures this in its policy stating soliciting donations "is not considered to be a commercial activity because donors do not expect any good or service in return for their contributions." In JKL Charity's case, the baked good given to the purchaser is classified as consideration in return for their donation.

It is also expected these activities, unlike businesses, have designated start and stop points within a fiscal period rather than being held on a continuous, year-round basis. This is not simply to deny a charity the opportunity to compete unfairly with a for-profit competitor, in itself a sufficient reason, or for CRA to minimize revenue earned free of taxes. It likely is a reflection of the premise charities should only fundraise when they have identified a need for funding in their strategic planning.

In CRA's words "Registered charities can only raise funds that are necessary to fulfill their mandates....when a charity has sufficient income for its identified uses or needs, the need for new fundraising may be questionable." Put another way, charities are not supposed to fundraise for the sake of fundraising. It then would not be practical to operate a year round retail operation if it was expected that the operation would cease, at least temporarily, when the charity had raised enough funds. Strategically, this would not be an effective way to run a business.

CRA policy aside, a reasonable question to ask in this scenario is whether social impact could be increased if JKL Charity put more resources into the bake sale. In a business sense, the bake sale could be viewed as having to have at least a 50% profit margin to be in compliance with CRA policy. If they were able to double their revenues, even a decrease in their profit margin to below an acceptable level may still give them more funds for their programs. For example, instead of revenues of \$100, expenses of \$30, and net income of \$70, they now show revenues of \$200, expenses of \$110 and a net income of \$90. The investment into the bake sale has brought in an extra \$20 dollars.

Simply investing more money into any fundraising initiative be it an event, a mail campaign, or the sale of a good or service, will not necessarily bring about a proportional gain in revenues. The relation between donor or purchaser motivation and the charity's mission would play a vital role in the effectiveness of the launch and growth of an initiative including a bake sale. It becomes a question of whether an increase in production of the product will garner enough interest to make it viable or even keep margins positive. As with any business or business-like undertaking, the possibility of losses enters the picture which would need to be covered by JKL Charity to the detriment of its charitable programs. Making an investment to try to increase revenues would add to this risk.

I believe there is a strong correlation between the popularity, for lack of a better term, of a charity and the public's response to their solicitation efforts. Charities that serve larger constituencies or whose missions are more widely known will generally be more successful. I always suggest to charities to try to stay within their means and not to necessarily expect the same success rate as a charity that brings in significantly higher fundraising revenues.

If JKL Charity has always sold about \$100 worth of baked goods then I would caution them trying to double those revenues may be unrealistic, the \$100 may be representative of public interest in their mission. This does not mean they should not invest any resources but expectations should be tempered. I would suggest a 25% increase in revenues may be a more appropriate target that will allow JKL Charity to attempt to increase their surpluses without taking on an unreasonable amount of risk financially and from a compliance perspective.

Strategically, I would advise to all charities to allow any fundraising activity the opportunity to find its place in their overall fundraising strategy. Cancelling an initiative after one year due to unrealistic revenue goals is obviously not an effective use of social capital and resources. I believe the Fundraising guidance recognizes and stewards this approach.

Is there an unlimited market for fundraising dollars?

Some charitable sector advocates (not necessarily from the SE community) would argue that as long as net incomes increase, JKL Charity should be able to invest resources into the bake sale. This is based on the premise there is an unlimited or untapped market for fundraising dollars and a business-like approach with business-like profit margins beyond the scope of regulatory oversight could lead to more funds being directed to the sector. This is particularly apropos for the sale of fundraising goods as a retail element is seemingly added into the mix of supporter engagement.

A more extreme opinion is that charities are selling a product in the form of social change through its programs and services and the public is 'purchasing' this product through donations. As long as a charity's overall net fundraising revenues increase, it is okay for the charity to keep investing resources into fundraising. I do not believe that there are too many supporters of this idea in or outside of the sector.

At the other end of the spectrum, other groups, usually ones who do not have a direct connection to the sector, believe there is a finite amount of fundraising dollars available to an ever increasing number of charities, and organizations who spend 'too much' on fundraising according to standards set by these groups' own agendas, are only taking money away from others.

Based on formal and informal research I have done, my guess is that it would be closer to the latter more so than the former. I believe there is to a certain extent a finite amount of fundraising dollars available but its growth is still ahead of the

rise in fundraising expenses meaning the overall net growth (social impact) is still positive. It is no secret that competition for donations and fundraising dollars has increased exponentially over the last 20 years and a review of some of the largest fundraising charities in Canada clearly shows it is becoming more expensive to generate fundraising revenue than in years past. *(I believe the sector would be well served by a formal research project that would indicate the trend in fundraising revenues and expenditures.)*

In addition, I would question whether there is a true retail element in the sale of a fundraising good by a charity. People usually are willing to pay more, e.g. \$3 for a chocolate bar or \$5 for a baked good, or make a purchase of a product they normally would not buy such as entry in a scramble golf tournament or a gala dinner tickets, based solely on its social connection. Without this connection, these goods likely would not be competitive in the marketplace from a pricing standpoint or generate enough consumer interest to be viable. In other words, the market for fundraising goods is somewhat limited.

Based on this, I believe a concern for potential diminishment of overall social impact arises from a scenario of removing regulatory limits. Like individuals making a donation or volunteering their time, consumers would feel a sense of achievement from their purchase that may affect their decision process when presented with another opportunity to support a social initiative.

For example, operating as an unrestricted business activity means rather than JKL Charity launching a bake sale with the intention to generate at least a 50% profit margin, they would be satisfied if it generated any surpluses. The bake sale could have expenses of \$80 but still would be considered a success as the net revenue of \$20 (\$100 less \$80), a profit margin of 20%, is available for JKL Charity's programs.

If an individual made a \$10 purchase of baked goods, they would feel the same sense of satisfaction as a \$10 donation but in actuality only \$2 would be put towards the cause as opposed to the majority of a donation. In the larger picture, \$10 has been removed from the pot of available social capital that could have been directed to another charity where the majority of it would have gone towards social impact.

Another issue to consider is, similar to businesses, charities have the propensity to copy successful fundraising models of other organizations. This is exemplified by the number of organizations who have introduced fundraising golf tournaments, sell candy bars, and operate lotteries. There is no reason to believe that if JKL Charity showed they could generate a surplus from their bake sale, others would follow. Accordingly, JKL Charity's profit margin may be reduced to 10% instead of 20% because of increased competition leading to an even lower amount of social capital (\$1 versus \$2) being directed towards social impact.

In the larger picture, since other charities would also be offering fundraising goods with low profit margins, the amount of social capital being filtered through activities where very little actually reaches charitable programs is increased exponentially. Similar to businesses, all of these organizations would operate their activity as long as its margins stayed positive. As margins decrease, the opportunity of losses for some of these charities increases meaning social capital would have zero impact.

A \$100 example may not adequately quantify the potential negative effect of allowing the sale of goods for fundraising purposes to occur outside of the scope of the Fundraising guidance. This activity brings in billions of dollars annually and is operated by thousands of charities. The competition dynamic, decreasing profit margins, and the risk of social capital has already occurred in the operation of lotteries where at least one charity lost millions of dollars from a house lottery after attempting to gain market share in an overly crowded market.

In my opinion, there is no reason to believe charities would not have the same success, or more aptly failure rate as is seen in the business world if the sale of fundraising goods were unrestricted. As mentioned above, there is nothing from stopping any charity from exploring a fundraising idea or growing a current one, it just has to be done according to a different profit margin.

The sale of fundraising goods as a business

SE narrative would appear to support operating these activities as a business outside of the scope of any regulatory limits such as the Fundraising guidance based primarily on the 'destination of profits' test and the seemingly unlimited potential of

'socially conscious' consumerism. The opportunity for unrestricted growth would also open the door for financing and investment capital from socially minded investors.

In addition to the apparent retail element present in the sale of fundraising goods, the belief among SE promoters also seems to be that 'social' consumers, those who choose products that have a social element connected to them, would enable higher revenue and profits than are currently being realized within the confines of regulatory measures. JKL Charity, for example, could get a larger share of the baked goods market because consumers would choose their products over other baked goods that would not be making any social impact. To make their goods available to this target market they would invest in retail space and operate year-round.

Likely to a greater extent than charitable sector advocates, what is not realized or understood by SE promoters is the possibility of private benefit being more dominant than public benefit putting social capital at risk and lowering social impact.

Also less understood is 'social' consumer interest is probably affected by the lack of a true retail element in the sale of fundraising goods. Social consumers may choose a product of similar quality and pricing over another because it has an association to a cause but unless they are motivated like a donor is motivated by a specific cause, the question becomes whether they sacrifice quality and/or cost for a 'social' product, a challenge acknowledged by some SE promoters. For example, would a social consumer pay \$5 for a JKL Charity's baked good when the same good is available from another store at a lesser amount?

Another potential risk factor would be the conflict between any capital investors and the SE as a return on their investment would need to be factored into planning, automatically reducing net income available for programs. Efforts to provide a competitive financial return may result in the SE taking on a more than reasonable amount of risk to increase revenues which could result in fewer funds for its charitable programs and a less effective use of social capital.

I believe the 'SE as a cause' influence is also prevalent in views about the unrestricted sale of fundraising goods and services. This is easily fueled by a common sentiment from the social sector that despite it being "tasked with solving some of society's most intractable issues", it is underfunded and becoming more so as government funding is cut. Since the government is failing in its mandate to provide proper support to those in need complaints by private business in competition with SEs who are earning tax-free revenue are dismissed. Adding to this feeling is the sense the promotion of economic development by government through business loans and grants is usually not available to purportedly 'non-profit' businesses.

Until sector research indicates there has been a decrease in overall government funding, I am not sure it should be accepted into social sector narrative. Research may be hindered as data accumulation could prove to be difficult. Although the amount of funds directed from all three levels of government towards the charitable sector can be easily calculated from T3010 Information Returns, any funding directed to NPOs would be much harder to track as they are not required to complete the same detailed form.

Another variable in this discussion could be the increase in the number of organizations with public benefit missions who are seeking funding from the same sources. Each of these organizations would have general administrative expenses to pay for along with program expenses. It seems to be a well established opinion the sector would be better served if organizations with similar purposes perhaps joined forces, and those with different missions could work within an umbrella organization that provides administrative support. This would lower the overall sector need for general administrative funding.

As for the social sector being 'tasked with solving society's issues', I would say this is accurate only for organizations who have received 'public' money in the form of grants and donations and are obliged to use that social capital to forward their missions. Rather than being the exclusive medium in which to tackle social issues, I view the social sector as a conduit for the community as a whole to affect change through philanthropy, volunteerism and government support.

Should a charity establish a formal 'fundraising' business?

In order to explore the potential of socially conscious consumerism without risk of social capital could a charity incorporate a separate, for-profit entity to sell retail goods? The products would be positioned the same as fundraising goods - purchase of them will create social impact as proceeds of their sale will be directed towards the charity via distributions and/or

donations of the for-profit entity's after-tax income (likely 75% or more of net income could go to the charity).

In my opinion, the rules against bestowing private benefits to the corporation, the potential for losses, and the negative reaction from supporters that would accompany this make this strategically unattractive. A charity would not be able to provide any private benefit (i.e. social capital) such as financial assistance, free use of office or retail space, use of staff or volunteers, etc. to the business to support its operations. Unlike a fundraising initiative operated by the charity where in-kind donations and volunteers can contribute to net revenues, the corporation would essentially be on their own.

This seems reasonable as the use of social capital to generate revenues and profits for the corporation would clearly be less effective (and more risky) than using those resources to directly deliver the charity's programs. For example, if the charity transferred \$10,000 to the corporation to help launch the business, then the business would need to generate more than \$10,000 in net income just to break even.

Hoping the corporation will be able to sell its products based on its association to the charity is simply not a good business idea and fraught with warning signs. Unless a niche in the market has been identified, there is no reason to believe the introduction a product similar to others already in the marketplace would be able to generate enough revenue to be sustainable, let alone profitable. This would apply to any business venture.

If the belief is the niche will be the social element attached to the product, this effectively applies a cannot fail condition on the corporation. If the company fails to generate any profits, then its consumers' have had no social impact which will reflect badly on the charity, potentially dampening future solicitation efforts to those consumers and possibly to the community. No one wants to hear that money directed to a cause did not reach its intended recipients.

This scenario also brings up other potential issues such as accountability and transparency. The business is relying on public goodwill towards the charity's goals and mission effectively making the business' activities the charity's activities, which are normally expected to be accountable and transparent. The business would be under no regulatory obligation to divulge financial information or be under any regulatory scrutiny for its activities.

This last point may seem like a non-issue given the legal connection between the two entities. One would expect the business would operate in a manner that is conducive to the charity's work. This may not be the case. If the business has an arm's length board of directors there is no guarantee the business, in its efforts to generate revenues, would not operate in a manner independent of, and possibly in conflict with, the charity's values and standards.

Independent operation can also arise if the corporation is not controlled by the charity through share holdings. In order to raise the necessary capital to launch the business, the corporation may have to issue shares, enough where the charity does not hold a majority position thus relinquishing control over the corporation. This may seem unusual but from a business perspective it makes sense.

Providing opportunities for social consumers could be accomplished through a cause-related marketing (CRM) arrangement between a charity and a for-profit entity. This is a formal agreement that usually involves a private retail business placing a charity's name or logo on its products in return for a negotiated fee or a payment per product sold (e.g. \$1 from every sale of this product will be donated to support a cause).

Although not prohibited, I would not suggest a charity incorporate a separate entity to serve as a CRM partner unless they have identified a genuine retail business opportunity, one that could be sustainable with or without CRM. If the charity is simply trying to sell fundraising goods outside of Fundraising guidance parameters via the company, I believe it would be more strategic to do this within the charitable entity where public interest in their cause can be leveraged more effectively.

Social Enterprise as a Profit Generator

It is stated in a few resources SE can have different motives, one of them being to "generate profits in order to enjoy greater community impacts or to lessen reliance on funding". I would interpret this as a SE activity that does not deliver any social impact (public benefit) from its actual operation other than the surpluses it is able to direct to a social purpose. Business activity (as defined by CRA) and fundraising appear to be viewed as profit-generating SE.

One SE idea that would fit this description involves the retail sale i.e. in the marketplace on a for-profit basis to the public of an essential good or service. A grocery store that sells healthy food is a common example. The strategy is to generate sur-

pluses from retail sales which then will be used to provide the same good or service to a marginalized group or community for free or at a subsidized rate. The thinking appears to be for-profit sales would be bolstered by 'social' consumer interest and/or interest in the SE's cause which could also attract investment capital.

It is positioned as a sustainable, market-driven solution to a social issue. Rather than relying on traditional, unsustainable charity funding normally needed for fee-for-service program infrastructure, this SE model can be developed using traditional business methods - capital and financing from investors.

SE resources suggest both the for-profit activity (the retail sale) and the delivery of the program could both operate within a charitable entity. I believe this is based on a misinterpretation of how a service-subsidized charitable program works where an essential good or service is offered at more than one price level to accommodate lower income clients. The difference is the good or service offered to lower income clients is not reliant on sales at the higher price level. In the SE model, goods and services are only offered to the marginalized group if the for-profit activity generates a surplus.

Similar to the scenarios outlined above, a charity operating this type of SE brings risk to social capital and the charity's reputation if no profits are generated. I would say there is even a higher risk to social capital in this particular SE model due to the potential use of program funding to cover expenses in the retail operation.

Use of traditional charity funding?

In apparent contradiction to SE's ideology of sustainability, the use of traditional program funding is not discounted by some SE promoters. As mentioned in Part 3, SE can be operated using grants and donations according to one common SE definition. In this broad mindset, funding can be viewed the same as conventional business capital investment where instead of dividends to shareholders, the return is social impact. Impact can be generated directly through program delivery or indirectly through a profit-generating SE where surpluses are used to fund programs. Whether it is on a temporary basis until a SE becomes financially sustainable or on a permanent one, there is recognition that a SE may only be able to compete in the marketplace with the help of funding and donations. For some self-identified SE practitioners, it seems this is their strategy. This means social capital (program funding) could essentially be filtered through the retail operation rather than spent directly on the delivery of the charitable service, minimizing its impact.

For example, ABC Charity from Part 5 decides that in order to ensure accessible and affordable transportation for its clients, it will operate a retail service in the marketplace in order to generate profits which will then be directed to the charitable program. As it is positioned as having affordable and accessible transportation as part of its social mission and its SE is positioned as sustainable alternative than traditional charity, ABC Charity solicits funding and donations in order to develop the infrastructure for the retail operation.

Unless the retail operation can provide a return greater than the funding/donations put into it, this is a less effective use of social capital. If the retail operation does not break even, then social capital will have had zero impact. This scenario also brings the risks and consequences mentioned in Parts 5 and 6 such as funder/donor wishes not being respected, complaints of inequitable distribution of funding by other charities, and a negative effect on the funder's overall community impact.

There is also the added element of potential brand confusion and strategic conflict. If ABC Charity is marketing a for-profit transportation service that is not affordable and accessible to their clients then there may be confusion in the community about what their mission is and whether it has changed. The retail operation may also be strategically limited from offering a more lucrative higher end service as this could be viewed as in contradiction to their values.

To avoid these conflicts I believe cause-related marketing would be a good strategy for this type of SE. ABC Charity could incorporate a for-profit business to operate the retail transportation service, or a much better option is to reach a CRM agreement with a current service provider. This would reduce both the time and resources needed to incorporate and the risk associated with launching a new business.

This relationship could be further enhanced by a partnership that sees the private provider, acting as an intermediary, operate the service end of the charitable transportation program. An intermediary arrangement could also work for the healthy food initiative, where a social entrepreneur could be either the business or the charitable end of the initiative. A charity/business partnership could also result in targeted purchasing by socially conscious consumers where, similar to CRM, buying a product is viewed as supporting a public benefit organization given the formal connection between the two organizations.

An intermediary arrangement could also be an option for another frequently mentioned social issue - affordable housing. Instead of a SE idea that would see an organization operate a rental property that charges market rates for some units and reduced rates for other units, a charity could provide affordable rental housing to the poor through a program related investment (PRI) made to a arms-length corporation that owns a housing complex. This would eliminate any conflicts or diminishment of social outcomes that may arise within the SE.

Another profit-generating SE idea is to operate a retail food and beverage operation that would also serve as a centre supporting community engagement. The belief appears to be that simply incorporating as an NPO, where potential profits would not be distributed to private shareholders, confirms them as a SE and justifies use of social capital to compete against other private establishments in the community. As public benefit is seemingly ingrained in the retail food and beverage operation, its sustainability becomes a cause in itself, suitable for funding and donations.

In my view, this is the clearest example of SE being in intrinsically unfair competition with tax-paying entities. As mentioned in Part 5, regardless of pricing structure, any new entry into the market potentially takes away business from current providers. Operating on a tax exempt basis alone gives the SE an advantage to take away customers from established businesses as everything else being equal, it will have extra capital to put back into their business.

This would appear to create incongruity between the SE's goal to alleviate social issues through community engagement and its contribution to said issues, however minor, by diminishing the earning power and sustainability of other establishments. Private business owners and employees may become in need of social services due to layoffs or closure.

I would suggest the goal of creating a centre for community engagement could be accomplished without having to establish a commercial business. To avoid any compliance or community goodwill issues, the centre's food and beverage needs could be provided by a private supplier who would pay the organization a fee for that privilege.

Another SE idea sees a charity operating a retail business activity that would be complimented by the sale of donated goods rather than the donated goods being the sole product. For example, a hardware store that sells donated construction materials. Besides the risk of operating a business and competition issues, the dynamic of selling donated goods in the marketplace also needs to be considered which will be discussed next.

The Sale of Recycled Clothing and Goods

This activity is frequently mentioned as an example of a profit-generating SE promoting environmentally-friendly recycling. On the surface it appears to epitomize the common SE definition - the marketplace sale of goods and services by a non-profit - with its double bottom line of financial (unrestricted funds) and social or environmental (reduced landfills).

In CRA's words, selling donated goods "is not considered to be a commercial activity because businesses do not depend on donations to create their inventories. Further, in selling off donated items, the charity does not assume the costs or level of risk usually associated with running a business. Rather, it merely seeks to convert a donated asset into cash." Items donated for a fundraising auction would be a common example of converting a donated item to cash that likely fits this description.

In CRA's now outdated **Registered Charities: Community Economic Development Programs** guidance issued in 1999, the sale of donated clothing through 'thrift' stores was listed as an allowable program activity if it furthered a charitable purpose. Presumably the activity is the provision of essential goods to clients to alleviate poverty. Similar to fee-based charitable programs, one would assume the sale of goods is on a cost-defrayed basis as opposed to generating surpluses. This makes sense as charging prices higher than what is needed to operate the program would bring into question its benefit to the public.

One legal opinion has offered CRA takes the position thrift stores may be recognized as a charitable activity "if located in sections of a community inhabited largely by the poor, sell donated goods at a low price, and operate on a break-even basis." In regards to other contexts in which sales can take place, legal opinion indicates CRA has stated that stores which are run as "fundraising vehicles" will not be separately registered, but may be considered a related businesses. This would appear to contradict the policy noted above stating selling donated goods does not meet the criteria of a business activity.

Perhaps the reasoning behind the different treatment of ‘fundraising vehicles’ is the fact CRA’s formal policy position on selling donated goods would appear to not be germane to a charity that chooses to sell donated goods on a for-profit and continual basis - an activity which would rely on donations to create inventories and would assume usual business costs such as the collection of goods and the retail store operation. ‘Fundraising vehicles’ would seem to not be simply converting a donated asset to cash.

Whether the for-profit sale of donated goods is considered fundraising or a business, and if a business, whether it would be considered a related business, does not appear to be clear in CRA policy. If considered fundraising, operating this type of activity with business-like margins may be offside of the Fundraising guidance.

Donated items appear to be collected and sold in the charity sector in the following three contexts:

(1) As part of an activity that provides essential goods to persons in need at no cost along with operating a retail operation on a for-profit basis to generate surplus funds. It does not appear goods are only sold to cover the costs of providing the essential goods. In my view, rather than being a charitable activity, there are two distinct activities, a charitable one (the provision of goods) and a for-profit one. If this was operated as one activity - a charitable program on a cost-defrayed basis - then the costs associated with the collection of donated goods could possibly be considered a program expense rather than a possible fundraising or business expense.

(2) To generate surplus funds by selling all of the donated goods to the public in a retail store operated by the charity or by selling the donated goods to a for-profit retail business. Some charities promote this activity as being environmentally-friendly as goods that might otherwise go to a landfill are recycled. SE narrative usually includes this characterization to substantiate a double bottom line claim.

As noted above, it is not completely clear how CRA categorizes the for-profit sale of donated goods. Some charities itemize revenues and expenses associated with the activity as fundraising. Some charities operate this activity through a NPO likely in an effort to eliminate any compliance concerns.

(3) Via a cause-related marketing (CRM) agreement between a charity and a for-profit company that sees clothing and goods given directly to the company who sells them on a for-profit basis. In return for use of its name and/or logo, the charity receives a fee.

If partnering with a for-profit entity, charities have to be cautious to not confer a private benefit which would be determined by an examination of the compensation paid by the business to the charity for the donated clothing and goods or the terms of a CRM agreement.

The interpretation in the SE community (and likely by most in the charity sector as well) is donated clothing and goods is not the same as a cash donation or even other types of in-kind donations, and their sale is more like a business or business-like activity. The thinking seems to be since most people have used goods or clothing to donate, giving them to a charity is not so much a gift based on the usual solicitation methods and donor motivations but rather simply getting rid of unneeded items. Rather than holding a yard sale themselves, they are given to a charity so they may reap the benefits from selling them in the marketplace.

There is also likely not a distinction made between the sale of donated goods as part of a charitable program and sale on a for-profit basis in either a charity’s own retail store or by a for-profit company. Both appear to be providing essential goods at affordable prices to a segment of the community in need. But as with any fee-based charitable program, any fee charged, regardless of whether it is just below market rates or deeply discounted, potentially excludes people from accessing the goods which brings into question the benefit to the public.

For-profit companies would also not necessarily sell their goods in an accessible manner which would be beyond the control of a charity once the goods are in the company’s possession. It may make business sense for the company to locate their store outside of communities largely inhabited by the poor or sell the goods in another country where consideration for accessibility and affordability might be considerably less .

This thinking should also apply to the environmental aspect. If a charity’s goal is to protect the environment through recycling, this would be accomplished by ensuring reusable goods are made as accessible as possible through a charitable pro-

gram operating on a cost-defrayed basis. Environmental impact would be compromised if distribution of the goods was hindered by charging more than what is needed to operate the activity or by a for-profit company's conflicting motives.

Should donated goods be sold on a for-profit basis?

The sale of donated goods is unique as unlike other fee-based charitable programs, charities seemingly have the option to sell a good on either a cost-defrayed or a for-profit basis. This brings up the question of whether it is reasonable to expect charities to expend donated items on its charitable programs and only if there is a surplus of items, convert them to cash; or for the charity sector as a whole, to expect all donated goods to the sector to be used principally on charitable programs.

It is not clear whether charities from the first example (those who use donated items in their programs and also sell them in a retail manner) give priority to their charitable programs over their retail sales when goods are received. If they need to cover costs associated with retail sale operations or meet a specific revenue target, this may necessitate priority of the donated items to the retail activity.

In my opinion, this raises the question of whether charitable outcomes are being compromised. Is social impact lower if donated items, one that could be used to their fullest capacity in a charitable program, are sold and net revenues are less than their donated value? For example, a charity whose purpose is to relieve poverty could provide \$10,000 worth of donated clothing and household items to their clients. If these goods are sold to the general public instead, then they likely receive a net amount of less than \$10,000 after operations costs or a wholesale rate purchase price from a for-profit partner are factored in. In SE context, the financial bottom line would be in conflict with social bottom line.

The same thinking applies if you include charities from the second example, those who solicit used items for retail sale only. They would be in competition with charities that plan to use these items in their programs. This would appear to clearly create a situation where donated items are not being used to their full capacity. This also brings up the issue of donor intentions. Are donors aware or understand their in-kind donations will not be used on charitable programs or necessarily sold in their community, or that a company could profit from their donation?

There seems to be a fundamental question of what is the appropriate use of donated clothing and goods. It is hard to deny donor intention that these goods be offered charitably to those in need rather than being sold in a manner that may limit their accessibility. There is also an element of private benefit in the form of profit made by for-profit partners which brings into question whether any level of private benefit is acceptable in converting a donated asset to cash. If deemed to be an allowable related business, how does one ensure private benefit is incidental to the achievement of the pursuit of charitable purposes, or, in layman's terms, to ensure for-profit partners do not profit unfairly from the goodwill of the public?

There appears to be a trend due a crowded competitive market where payments from charities to for-profit partners are becoming lower and lower percentage-wise in relation to the value of the goods they are receiving. There is a high demand for business partners, the lower the percentage of payment a charity is willing to take, the better chance a charity has to acquiring one. From a charity's perspective, the position seems to be that any funds generated from collecting and selling used goods is a positive. As long as charities need to fundraise, this percentage will likely continue to decrease.

In my view, this is another example of the competition dynamic amongst charities for fundraising revenue resulting in decreasing profit margins except the market or source for used clothing and goods is probably more finite than the market for general fundraising (e.g. funds available, people willing to donate). Like other potential SE ideas operated by charities, the larger picture sees revenue growth by an individual organization likely at the expense of overall social impact. If more money from the solicitation and sale of used goods ends up in the hands of organizations or individuals who are not 'the cause', the whole charity sector suffers.

This is an activity that may require further regulatory clarity or changes to answer these questions.

Part 8: **Activities of Registered Charities - Related Business**

Overview

Content regarding related business is perhaps the most referenced CRA policy in SE resources. As mentioned in Part 2, related business (incidental business) is a topic that is mentioned often as it presumably opens the door to unrestricted business activity for charities as long as a connection can be established. If the activity is mission-related, i.e. it delivers an essential good or service or supports the employability of a marginalized population, then funding and donations can seemingly be solicited to support a SE's double bottom line.

It has been acknowledged in some SE resources specific to legal structures that many organizations operating a self-identified SE mistakenly believe they can operate a charitable program as a related business to generate surpluses. This is likely the result of:

- the ambiguity of SE
- the use of terms such as 'related', 'linked, and 'direct connection' in CRA policy
- suggestions by SE promoters that CRA policy is not clear
- the attraction of unrestricted revenue generation
- the perception that it's okay to earn 'social' profit

The common practice in charitable and NPO sector statistical analysis to place revenues derived from both charitable programs and related business in one category usually called 'Earned Income' can also contribute to this dynamic.

My interpretation of CRA policy is it is clear that related business is not the medium to operate unrestricted business activity its prevalence in SE resources would seem to indicate. There are very specific conditions and circumstances that a charity can leverage to generate surplus revenue but nothing that can be broadly applied to charities or applied at all to for-profit entities. Neither does it provide an opportunity for capital investment, in theory, one of the advantages of operating a SE.

What is a Related Business?

CRA indicates there are two kinds of related businesses:

- (1) Businesses that are run substantially by volunteers e.g. church bazaars or a volunteer fire department bingo night.
- (2) Businesses that are linked to a charity's purpose and subordinate to that purpose.

The 'destination of profits' test would appear to be inapplicable as CRA policy states "the fact that the profits from a business are applied to a charitable purpose is not sufficient to constitute the necessary linkage."

CRA lists four forms of connection or linkage that have been identified, the first three appear to occur or emanate from the delivery of charitable programs. In my view, they do not offer any practical or strategic opportunities for unrestricted business activity.

(1) A usual and necessary concomitant of charitable programs

As per CRA "these are business activities that supplement charitable programs. Either they are necessary for the effective operation of the programs, or they improve the quality of the service delivered in these programs." This is likely the most common type of related business; examples include hospital parking lots and cafeterias, museum gift shops, and university book stores.

In my view, this does not present an opportunity to sell goods or services in the marketplace. For example, a hospital parking lot is expected to be located next to the facility, not in another part of town where higher revenues could be generated. If this was the case, the question would arise whether the lot would be effective in providing parking for hospital patients and visitors or necessary for the hospital to operate. If a museum gift shop sold anything other than museum-themed gifts such as retail goods like groceries or clothing, the same question is likely asked.

(2) An off-shoot of a charitable program

In CRA's words, "in the ordinary conduct of its charitable programs, a charity may create an asset that it can exploit in a business. The charity carries out its charitable programs, not in order to create the asset, but to achieve its charitable purpose. The asset is simply a by-product of the charity's programs."

An example would be crops produced from an 1800's heritage farm that can be harvested at the end of the season and sold in the marketplace. I would describe it as restricted as the production of the good is incumbent on the delivery of a charitable program. For example, if the heritage farm planted crops in a way that wasn't reflective of an 1800's farm, then the question arises whether it is an off-shoot of their charitable program.

One SE idea is to sell a good created from a charitable program based on market demand rather than as a by-product of the program. The belief is the product's association with a social cause may generate interest from consumers. I would question this activity from a strategic perspective as efforts to generate surpluses, like any business venture, would be financially risky, especially if investment or financing was involved. This scenario brings the same risks and consequences associated with other SE ideas that look to mix for-profit intentions with charity programs.

If a charity has identified a market for a good being produced in the course of a charity program, I would suggest they incorporate a separate for-profit entity to avoid any compliance and social capital risk issues.

(3) A use of excess capacity

As per CRA "this type of business activity involves using a charity's assets and staff, which are currently needed to conduct a charitable program, to gain income during periods when they are not being used to their full capacity within the charitable program." Examples include the rental of parking places, building space, or equipment when not in use by the charity.

In my view, this business activity has a clear restriction of only being allowed when an asset is not being used in its normal charitable capacity. If the asset was used in a manner that conflicted with its normal use then the question arises of whether its charitable outcomes are compromised. If an asset is no longer needed, the expectation will be the charity will dispose of it.

Utilizing unused charitable assets to generate revenue is a common SE premise but their use does not appear to be limited to periods when not needed to conduct programs. One idea is to leverage office space after normal working hours to operate a year-round business. There are likely questions whether this is an allowable use of excess capacity. The charity would be for all intents and purposes committing to not using their office infrastructure when the business is operating regardless of their needs to deliver their charitable programs.

If financing was used to launch the business, this could add to this potential conflict. Given the SE's double bottom line, financial goals or realities could expand the business' usage of space beyond the original plan, an even larger infringement on charitable outcomes and risk to social capital. If a business opportunity has been identified, then a separate for-profit entity would again be suggested.

I believe the same analysis applies to the scenario from Part 6 that sees DEF Charity trying to leverage its infrastructure to produce woodworking products for marketplace sale outside of the scope of its charitable program. Other issues such as increased wear and tear on its production equipment would also affect its program delivery as maintenance and capital costs would increase.

(4) The sale of items that promote the charity or its objects

In CRA's words "this type of business activity is linked to a charity's purpose because it involves sales that are intended to advertise, promote, or symbolize the charity or its objects ...Usually, the items are bought by those who want to contribute to the work of the charity, and they do not compete directly with products produced and sold by for-profit entities".

Unlike the first three linkages, this activity does not directly originate from the delivery of a charitable program making it the only related business activity that likely all registered charities could carry out. It is clear this does not open the door to the unrestricted retail sale of goods nor present an opportunity for 'social' consumerism. Not surprisingly, it does not garner attention in SE resources.

Subordinate

Aside from the linked criterion, SE ideas that originate from related business activity would likely not fit the condition of subordinate either; or in being subordinate, the SE would be restricted in potential growth, an obstacle that makes business sense to avoid. In CRA's words, "a business is subordinate to a charity's purpose if it remains subservient to a dominant charitable purpose, as opposed to becoming a non-charitable purpose in its own right"

CRA list some questions that could arise to determine whether a business is subordinate including:

"In terms of expenditures, staffing, and assets such as buildings and vehicles, what proportion is applied to the business activity? If equipment or other resources are shared between charitable programs and business activities, how often are they used by the business?"

"Could the business operate as easily outside the charity as within it? Is it of comparable size to for-profit companies providing similar goods and services? Are the goods and services it provides indistinguishable from those offered by for-profit companies?"

"Has the charity risked the assets intended for charitable programs to support the commercial activity? For example, has it borrowed against resources used in its programs to finance the commercial activity?"

"Are decisions being made on a bottom-line basis without regard to the organization's charitable purpose? For example, is an art gallery stocking items in its souvenir shop on the grounds of what sells best and ignoring the charity's mission to promote artistic excellence?"

"How many salaried employees does the commercial operation have? Are the salaries much higher than those for equivalent positions elsewhere?"

Based on the linkages identified by CRA, it would not make practical sense for a related business to become a dominant concern of a charity. It is hard to envision circumstances where the operation of a hospital parking lot, rental of excess space, or sales a program by-product would take up significant time and resources, let alone the majority of them.

In my opinion, it is clear operating a related business takes place under specific circumstances that prevent the compromise of charitable outcomes and risk of social capital. CRA policy is not in place simply to ensure charity-run businesses do not compete unfairly with for-profit entities or earn an excess amount of tax-free revenue. Instead it stewards charitable resources and activities that provide public benefit, and in doing so, reveals the financial realities of operating an activity with a for-profit intention that makes unrestricted business activity disadvantageous for registered charities.

The concreteness of CRA policy for business activity appears to contrast SE narrative that proposes fluidity between a SE focused on profit generation and one focused on mission, the focus being dependent on the "motivation of the social entrepreneur". There is mention of 'mission drift' from a mission-based focus to profit generation but any indication that this introduces risk factors is absent, it is only mentioned for strategic purposes. "SE as a cause" seems influential as presumably all self-identified SEs, unlike non-SE businesses, are creating social impact regardless of their focus or use of social capital.

Why do SE resources focus on related business?

Depending on how SE is interpreted, the frequency of content on related business in SE resources would seem to be out of proportion or in contradiction to the common narrative of placing SE goods and services in the marketplace with no restrictions. I believe this is a combination of CRA policy misinterpretation and a focus on business activity with its potential of profit directed towards social change.

As a microcosm of SE as a whole, references to related business in SE resources is also confusing as it seemingly tries to fit every type of registered charity activity under an umbrella term or fashion as a singular concept despite the different intentions amongst them. Some SE resources cite examples of allowable business activities such as a museum gift shop or a hospital parking lot to establish, contrary to popular belief, charities are allowed to operate a business. This is then used to open the door to the possibility of:

- operating fee-based and employment-themed charitable program activity on a for-profit basis,
- selling fundraising goods at business profit margin rates, or
- operating a complimentary business activity (to be discussed in Part 10).

One SE resource indicates there is “no clear definition in legislation or regulation of what constitutes a legitimate linkage” likely in response to the above activities not being identified by CRA as being linked or connected. To the contrary, CRA lists legitimate linkages, ones whose connection to a charity's public benefit purpose makes practical sense, and clear policy for other activities that generate revenue through sales.

‘SE as a cause’ is also very prevalent as any business operated by charity is automatically a ‘good’ business which is given, or should be given, legal affirmation through the related business rules.

The reality that operating a good business will have the same financial risks as operating a non-SE business is usually acknowledged in SE resources but the use of social capital to reduce or eliminate these risks is not. Public support in the form of program funding and donations seems to be viewed as one of the benefits of operating a good business; a benefit that will enable profit or even out the competitive playing field with private businesses. It is looked upon as a tool for a commercial enterprise, similar to conventional business financing, or equated with public support directed to businesses in the form of government tax incentives, forgivable loans, and economic development funding.

This dynamic has led to perceptions of CRA rules around related business being unfair and archaic. One SE resource indicates self-identified SEs have had to spend money needlessly to ensure they stayed within the CRA parameter of just covering costs; the implication being if they were allowed to operate the SE as a related business, they would generate surplus funds for other programs. In the same context, another SE resource describes the likelihood self-identified SEs would be deemed offside of CRA policy as an ‘injustice’.

I strongly suspect the activities being referenced were, or are meant to be, the beneficiary of funding and/or donations giving the illusion of profit. If they were operating a business activity, rather than an activity that was attempting to mix in elements of program delivery, then the easy solution to their complaint of unfairness would be to incorporate a separate for-profit entity (an NPO may need to apply for charitable status to accomplish this).

Legal input and opinions

Content from members of the legal community on CRA’s related business policy and potential alternative for-profit organizational structures is quite prevalent in SE resources. I believe this creates an impression of credibility for SE to be viewed as a viable business option despite legal content not being complimented with any context as to what SE actually is beyond referencing various nebulous definitions and characterizations.

My impression is the legal information offered is simply the rules in black and white on allowable charity commercial activity and other options for legal structures where business activity can be operated. Legal content seems to be answering the question of whether a charity can operate a business such as a pizza place or a used car dealership that has no element whatsoever of social impact other than potential profit from said business would be used to deliver charitable programs. In contrast, SE narrative seems to be focused on deeper concepts and philosophies than selling pizza or used cars.

If SE is specifically mentioned in newsletters, commentaries or other communications released by law firms, the usual manner in which the SE topic is approached is to not assign it any legal standing. There is recognition SE is becoming well-established in social sector dialogue and strategy but this is accompanied with caution of the rules in place that restrict business activity for registered charities regardless of the whether said activity is called SE or not by organizations.

There does appear to be some discrepancy in interpretation of related business policy. One SE legal resource indicates some business unrelated to a charity’s objectives is allowed under CRA policy for Community Economic Development Programs. This would appear to conflict, at least in wording, with CRA’s position that charities can only operate CED activity if it is charitable or, if the activity is deemed to be a business, it must be related to charity objectives. As noted earlier, inclusion of the term ‘business’ by CRA in **Social businesses for individuals with disabilities** could contribute to the use of ‘business’ in a context other than CRA’s formal definition. Although this may be a case of the legal resource using language in a different context from CRA’s, it could easily be misinterpreted as allowing unrelated business activity by charities.

In my review of numerous SE resources, I have not found any definitive legal opinion that SE, however it is defined, can or should be operated by registered charities. One legal opinion does define SE but appears to limit it to being strictly a business as defined by CRA thus cannot be operated by a charity unless it fits CRA's related business criterion. This will be examined in more detail in Part 9.

Nor have I found any definitive legal opinion calling for a loosening of the related business rules or additions to the four connections identified by CRA*. To the contrary, at least one legal opinion cautions against allowing charities to operate unrestricted for-profit activity primarily based on a charity's liability for business losses and the premise "tax-supported donations subsidizing unprofitable businesses...would be, among other things, economically wasteful."

Some legal experts offer the opinion CRA policy for related business has not been clearly established by case law or in the Income Tax Act. This could give the impression, fed by the conflict of interest criticism directed towards CRA, that perhaps SE activity could be allowable. Legalities aside, I have not reviewed a SE idea that makes me believe from a practical or strategic sense a change to the rules is needed.

Some SE promoters advocate a change to CRA policy to allow charities to earn tax-free income from unrestricted business activity under the 'destination of profits' test. That other countries seemingly allow this is cited as an indicator that Canada is lagging behind and needs to update its policies.

I have not come across an in-depth review of activities operated by charities from other countries that would indicate whether unrestricted business activity is taking place or 'destination of profits' activity is not the same as related business activity in Canada. Similar to the federal/provincial legislation dynamic, I wonder if it is not simply a case of using different terminology to describe essentially the same thing. It could be stated charities in Canada are already allowed to earn business revenue tax-free under the related business rules.

** Although there was a member of the legal community who participated in the development of a report calling for specific changes to CRA related business policy which will be reviewed in Part 10.*

Earned Income

The term 'Earned Income' is commonly used to describe either:

- (1) Program Revenue - revenue generated from fees charged in the delivery of charitable and NPO programs or membership dues for member-based NPOs.
- (2) Program Revenue plus any other revenue derived from the sale of goods and services including revenue from incidental business (e.g. related business) activity.

Revenue from fundraising, foundation grants, and any government revenue (funding and/or sales) are normally excluded.

The second description is likely based on each of the revenue streams having the similar trait of a good or service being sold. This can sometimes lead to the inclusion of revenues from the sale of goods for fundraising purposes. CRA does not appear to formally employ the term in their policy so its use in statistical reports or in any other context by organizations connected to the social sector usually includes clarification as to what revenues streams their use of Earned Income includes.

Its usage for both the charity sector and the NPO sector (which normally includes charities) is an example of the apparent interchangeability of NPOs and registered charities. This can lead to different statistical findings in both total dollar figures and percentages of overall revenues. For example, one report from Statistics Canada indicates 45% of revenue for the NPO sector was from earned income. This figure would be strongly influenced by the inclusion of member-based NPOs that do not have public benefit missions. Another report, produced by Imagine Canada, indicated that Earned Income for registered charities was 10%, and revenue generation specific to the delivery of charitable programs and services was even less.

T-3010 Annual Information Return reporting

The similar categorization of charitable program-related revenue and related business revenue in Earned Income statistics for the charity sector may also be attributed to how revenues and expenses for both activities are reported on the T3010 Information Return, the direct data source for statistical analyses of registered charities.

Fees charged in the context of a charity program including revenue from the sales of goods and services from an employment-based charitable program are reported as “Total revenue from sale of goods and services”; as is income from any related business activity such as a parking lot or a gift shop. Similarly, any rents charged in charitable program delivery or from a related business is reported on the same T3010 revenue line. Expenses for program activities are categorized on the line titled “Total expenditures on charitable activities”; as are expenses associated with operating a related business.

This reporting requirement could create the impression that CRA views revenues and expenditures from a related business in the same light as those from charitable programs, that related business activity is in itself a charitable program. If related business is charitable then adding a for-profit element to a charitable program should be allowable and use of resources like funding and donations can be used without restriction. To the contrary, CRA states “expenditures on a charitable program can be used to satisfy the disbursement quota, but not expenditures on a business.” In other words, related business is not viewed as having a charitable purpose hence its different regulatory treatment.

Imagine Canada

Earned Income is mentioned often by SE promoters in apparent reference to SE activity in the charity sector, that Earned Income and SE are one in the same. This line of thinking is not limited to just the SE community, and likely is contributed to by sector support groups, most notably Imagine Canada.

In another microcosm of SE as a whole, Imagine Canada’s reference of ‘Earned Income’ in its resources is also confusing as it is seemingly tries to fit all revenue generating activity for charities under an umbrella term despite the different intentions amongst them. For example, they describe Earned Income as “revenue generating activities that involve selling goods or services to customers” which includes the full scope of registered charity activity. SE is referred to as “commercial activity by charities or nonprofits” and a part of Earned Income, seemingly giving credibility to its presence in the charity sector (they also describe one of their activities as a SE). This seems contradictory to other Imagine Canada resources indicating SE is best housed in a for-profit business entity (mentioned in Part 5).

What is lacking in my view by both the SE community and Imagine Canada is a clear comprehension of:

- the difference between program-related activity and related business activity
- the specific conditions in which related business can operate
- the distinction by CRA that related business is not charitable

This brings about the inference, especially in SE resources, that Earned Income, regardless of the revenue streams it includes, presents business opportunities. This is relevant as both SE and Imagine Canada’s resources present feedback from the charitable sector indicating there are barriers to the growth of SE/Earned Income activity. The primary barriers are described as a lack financial support, presumably the inability to obtain financing or issue shares; and regulatory, presumably CRA policy which restricts business activity and requires program revenues to just cover costs. I would question the usefulness of this feedback when it is not clear which activities it is felt are not being enabled.

This narrative takes on greater importance when Earned Income is noted as being the source of up to 45% of revenues for the NPO sector and billions of dollars of Earned Income revenue is cited as an indicator of the social sector’s economic impact. I believe the portrayal of Earned Income as business income which contributes to the economy in a manner similar to for-profit businesses can be misleading and can add to the cross-governmental morass at the federal and provincial levels mentioned in Part 6 especially with economic development agencies.

One particular Earned Income reference, a quote from a **Mowat Centre for Public Policy and Governance** report, is often used as a reason to support SE activity. It was stated in the report that “Charities and non-profits rely on three core sources of revenue: government funding, philanthropy, and earned income. Of these, only earned income offers any prospect for long-term growth.” It is unclear in the SE resources that reference this quote which specific revenue streams are being referred to in the Mowat report, it is likely interpreted by SE promoters to mean for-profit activity or activities with double bottom lines.

My interpretation of the report would be Earned Income is a reference to fees charged from public benefit program delivery and NPO membership dues as these would make up the majority, if not all, of any Earned Income figure. It also makes sense from a practical and strategic perspective, other revenue streams such as related (incidental) business would not, in my

opinion, have potential for growth.

Growing fee-based and employment-based charitable programs

I believe the Mowat report is broaching the concept of organizations charging fees for programs rather than the traditional route of seeking funding and donations to deliver programs free of charge. I would not necessarily conclude it is because sources of funding and philanthropy are necessarily diminishing, increased competition for these funds could also contribute to a sense of funding stagnation. If government funding is starting to be reduced, it may be the reality of funding social programs financed through taxation is proving to be unsustainable; charging fees within social program users' means would appear to be the alternative thus there is room for growth.

On the surface, this may seem to be in line with common SE narrative but the Mowat report likely is not advocating for unrestricted business activity by charities. In my opinion, an action plan from this assessment would be first to raise awareness amongst social sector stakeholders of fee-based and employment-themed charitable programs and the context in which they can have economic impact.

Context is important as while charitable programs may have business-like elements in the form of goods and services being sold enabling program sustainability, they should not be perceived the same as businesses where unrestricted revenue generation attracts conventional forms of capital. In my opinion, making investment capital more accessible to public benefit organizations supported with conventional economic development funding will not result in increased social impact.

Charitable programs require a more suitable, unconventional source of capital such as a Program Related Investment where yields (interest and dividends) and a return of capital can be secondary to the achievement of charitable goals. This removes the potential conflict of investor expectations from the equation. Loans made by individuals are another source of capital that could be encouraged with enhanced tax incentives. Other tax incentives and other government supports such as targeted funding for program infrastructure could be introduced to provide an enabling environment for sustainable social impact. Perhaps unconventional funding from economic development agencies could be considered.

I believe with increased awareness of the range of charitable program opportunity, the fundamental changes SE promoters are seeking can be accomplished through partnerships between charities and businesses. Partnerships could lower the need for third party funding, enable sustainability, and open the door to "social" consumerism and investment capital envisioned by the SE community. They could also provide an opportunity for individuals to explore the financial benefits of owning a business while delivering social impact.

Part 9:

Activities of Registered Charities - Unrelated Business

A registered charity can incorporate a for-profit entity to operate a business activity not permitted by CRA policy. In CRA's words, if a charity is operating an unrelated business "it is in breach of the law and could have its registration revoked" but does have the option to place the business "in a separate taxable corporation". A charity "can retain control over the taxable corporation through share holdings or a power to nominate the board of directors."

If a corporation is established by the charity it "can invest in the corporation on the same basis that it can invest in any other for-profit business. The charity's directors/trustees would need to satisfy themselves that the investment represents a prudent use of the charity's assets. They also need to be alert to ensure no benefit of a private nature is conferred on the corporation."

I would interpret this to mean an unrelated business essentially cannot leverage its association to the registered charity to try to generate profit. It would not be able to gain a competitive edge over other businesses from the use of social capital nor from financing by the charity based solely on the legal connection between the two entities. Like other businesses, its financial success will be based on the goods or services it produces and sells.

Examples of businesses started by charities include low-income housing property management and a language service. The business opportunities appeared to have been identified in the course of delivering a charitable program.

SE and unrelated business

A charity incorporating a separate for-profit entity would seem to be the apparent answer to the SE concept of operating a for-profit activity that directs profits to a social cause. It becomes even more obvious when SE characterization is narrowed further to charities operating business activities. It appears to be the best legal option for the marketplace sale of goods and services by a non-profit to occur, perhaps the only one depending on one's interpretation of non-profit. An unrelated business would not have to comply with CRA policy that limits sales, product production or entry to the marketplace, and one would assume all or some of the profits earned from the business would be directed to the charity through dividends and/or donations rather than to private shareholders exclusively.

As previously mentioned, SE narrative and promotion seems to be focused on deeper concepts and philosophies than the potential profits from operating a business, or at least, it is only part of the SE discussion. In my view, there likely are not many business ideas that would arise from the operation of charitable programs that would necessitate the considerable resources and attention that appears to be directed towards SE.

Should Unrelated Business be Supported?

A commentary released by the C.D. Howe Institute titled **At the Crossroads: New Ideas for Charity Finance in Canada** suggested SE could be supported through loans made by private foundations to unrelated businesses. This would necessitate a change to CRA policy that currently does not allow loans by private foundations to unqualified donees. For the purpose of the study, SE was defined as "the pursuit of business income to finance charities' activities".

On the surface, it would appear this is advocating for social capital to be used on business activity the study acknowledges would have the same risk factor as other businesses. This would seem to be a very inefficient use of tax-receipted donations, which in somewhat of a contradiction, was also acknowledged in the study. In my view, an unrelated business should rely on conventional financing from sources that would not base their decisions on anything other than the feasibility of the entity's business plan.

This scenario also raises the possibility of profit distribution to shareholders other than the charity if other financing is sought for the unrelated business. If there were other shareholders, would there be any mechanism to avoid a scenario that sees them benefiting from the unconventional financing terms of a PRI?

A closer look at the study reveals SE is not necessarily viewed as simply a business which perhaps explains the contradiction mentioned above. While the study recognizes there is not a consistent definition of SE, it does provide a characterization which positions SE as achieving "social purposes – and potentially profit thereby" through entities which "may be charities, not-for-profits, or even for-profit businesses." And that "social objectives may be cost-effectively achieved using market

tools.” While the study acknowledges business activity would have risk, those risks would appear to be alleviated or acceptable by the pursuit of social outcomes.

In my view, this characterization is not any clearer than other SE definitions and descriptions. Similar to SE resources, there is no real qualification as to how social purposes and profit can both be achieved or what constitutes ‘market tools’. It does have a different tone though as SE is approached on a theoretical level, rather than conjecture.

The characterization also seems to be in contrast to the study’s declared definition of SE as ‘business income’ which implies profits from an activity are earned first before being directed to a social cause as opposed to a SE that “achieves social purposes – and potentially profit thereby” which implies an activity has social impact while generating revenues, the so-called ‘double bottom line’ or ‘blended value’. While the study appropriately cautions against charities operating potentially risky business activities, it still gives SE credibility in a manner I would consider to be influenced by the ‘SE as a cause’ factor.

The study provides more commentary on SE which I believe gets to the heart of the SE discussion, at least on a philosophical level. It states “the desire to benefit from one’s endeavours drives private markets. The desire to ‘do good’ motivates socially minded actors. Social enterprise works because the two are not mutually exclusive (or people are prepared to limit one of their motivations).”

In my opinion, this commentary illuminates the reason why SE needs to be treated with caution by the charitable sector, the only one that is accountable to an external regulator to ensure organizations with public benefit missions ‘do good’. I have not seen a case put forth in SE resources that challenges the notion that private business and social impact are not mutually exclusive, or more specifically, that a SE’s financial bottom line, regardless of motivation or intention, would not emerge as the dominant or exclusive bottom line which could minimize social outcomes.

People may be prepared to limit their financial motivations in order ‘to good’, but how far can one limit their motivation to ‘do good’ for financial gain and still have social impact? If a financially motivated SE has access to social capital, how will social impact be measured and who would be doing the measuring? As SEs have double bottom lines, it is presumably delivering social impact so long as it is financially viable. This would appear to eliminate the possibility of drawing a line where a SE that is not delivering social impact is ineligible for social capital. Conversely, charities have a distinct line that they need to stay on the right side of in order to maintain their registered status and the public trust that goes with it.

Regardless of how SE is characterized, as has been mentioned throughout the article, I do not believe that operating an activity that attempts to mix charitable intentions with a for-profit motive makes sense strategically and puts social capital at risk. I see no reason to believe provision of an essential good to an identified community or an employment-themed program can be more cost-effectively achieved using market tools. For the same reason, I would caution treating so-called hybrid organizations any different from other for-profit entities in the realm of social program delivery. This will be examined in more detail in Part 11.

The study also mentions a common SE premise to view charity investment in a business in the same light as charity investment in a fundraising initiative such as a special event or a mail campaign - as long as surpluses are being generated, investment is justified. According to the study “the CRA should apply the principles associated with its fundraising guidance to the rules on charities’ provision of seed capital to subsidiary businesses.”

I do not believe this makes sense as business and fundraising are fundamentally two different types of activities, the principles associated with the fundraising guidance cannot be practically applied. As mentioned in Part 7, the solicitation of donations is not considered a commercial activity and there is regulatory protection against private benefit being more dominant than public benefit. In contrast, private benefit is dominant in a normal functioning business activity as public benefit, in the form of profit, is limited to traditional business margins, subject to traditional business failure rates. Put another way, non-compliant fundraising results in less effective use of social capital, an unsuccessful business means social impact is nil along with other negative repercussions such as donor dissatisfaction.

Leveraging the Charity/Unrelated Business Connection

Can an unrelated business leverage its association with a charity? As mentioned in part 7, I would caution against a business operation relying on its association with a charity to generate revenues as this effectively applies a cannot fail condition on the company. There could also be additional implications to a charity’s reputation in the community if a portion, potentially

a majority portion, of business profits were going to shareholders other than the charity. The accountability and transparency issue would also be amplified as the business would be under no regulatory obligation to divulge shareholder information or any financial information such as payments to them.

An even bigger issue may be the conferring of unacceptable private benefits on the company. If the company is relying on the charity's name and community reputation to generate revenues and profits, some of which are distributed to private shareholders, a question may arise whether it is fair that these individuals are profiting from the intentions of consumers to support the charity's mission. If a consumer was aware that anyone other than the charity was going to benefit, they may not have made their purchase.

Unrelated business as a 'community' business

I believe the same thinking also applies to a SE idea where a company leverages its association to a registered charity to fit a community business criterion for a government supported initiative.

In this scenario, a government agency launches a renewable energy initiative that invites participation by entities it designates as 'community organizations' which includes NPOs. These organizations will produce an energy source for a public utility to be purchased at an established price to ensure profitability for the 'community' businesses. The cost of the subsidy will be included in the rate paid by the users of the utility i.e. users will be paying a higher rate to guarantee the participating organizations' profit. The goal is to promote environmental sustainability and support locally-owned business that will reinvest profits in the communities where users of the utility live rather than distribute them to private shareholders located elsewhere. Other eligible community organizations include co-operatives, businesses owned by First Nations, and corporations specifically designed to be locally owned and financed.

A registered charity incorporated as an NPO recognizes it likely cannot operate the business activity - the production and sale of the utility's energy source - as per CRA policy so it incorporates a separate company which on its own would not fit the community organization criterion but its legal association to the charity appears to bridge the gap. The assumption seems to be there is community benefit from this activity in the form of program delivery by the charity using funds received from the company. This justifies the subsidy provided to the company which, in my view, should be considered the same as charitable donations and grants - social capital from the public directed to a charitable purpose.

To raise the necessary capital to finance the commercial undertaking, financing is sought from private investors in the form of loans. This is the only way private investors can participate in the initiative; if they had formed their own corporation they would not have been eligible. There is no stipulation that private investors have to be from the community in which the business will operate nor does there appear to be a cap on the amount of interest they will receive. In other words, there is no assurance of how much of the guaranteed profits will end up in the charity's hands i.e. distributed communally.

For example, the company needs \$1,000,000 for infrastructure which is provided by five investors who loan the company \$200,000 each. The expected annual return for the company is 7% or \$70,000. It is doubtful the investors will accept anything less than a market interest rate. In this case, market returns would be based on other investments which have a guaranteed return like a GIC. If market returns were 5% then investors would need at least a return of 5% to make it a worthwhile investment.

From the charity's perspective, they would not have an expectation of receiving a specific percentage or amount in this arrangement. Like other revenue generating activities, any funds directed towards them from the business will be a positive. Interest payments distributed to the private investors are viewed as the cost of doing business, the value of which has no hard stop as long as the charity benefits. The charity may be satisfied with a return of 1% or \$10,000, giving the private investors a 6% return.

With the charity not realizing the full benefit of the subsidy, I believe it is reasonable to ask whether the private investors are benefiting unfairly. The company is only able to participate in the initiative because of the trust and goodwill that accompanies a charitable registration so the business in essence is the charity in this case. But only a portion of the profits the company could potentially make are being directed to the charity despite being propped up artificially by social capital. Rather than public benefit being fully realized from the activity, there is private benefit; any amount of which could be construed as

unacceptable.

This is a unique scenario, a suggestion as to how a charity could benefit from this type of initiative in a manner that does not risk social capital or confer private benefit is not immediately obvious. I would question why NPOs, and NPOs with registered charity status, would be included as eligible participants as they are fundamentally not businesses. My guess is the answer would be a combination of the government agency not understanding the regulatory environment in which NPOs and charities operate, the charity/NPO interchangeability dynamic, and equating communal distribution of profit with the public benefit of registered charities.

Subsidized Capitalism?

The answer may also be the attempt to make what could be construed as a flawed public utility production and distribution delivery system less flawed. The government's intentions are ultimately to improve the conditions for local business activity in the belief social conditions will improve accordingly. By guaranteeing profit through fixed pricing, rather than being dictated by the market, the government is essentially subsidizing or guaranteeing capitalism. The product being a public utility makes this a different circumstance than the delivery of other goods and services but its combination with private investment brings into play for-profit motivation and the risk of social capital. The initiative may be designed to ensure profits are distributed communally but there is nothing to stop non-community organizations from getting most of the benefits from the subsidy.

Even if investors were from the community In the example above, there is a possibility they would borrow funds to finance their loans to the company. This would make business sense as they likely can borrow at a rate less than their expected return. For example, an investor takes out loan at a 5% interest rate which is covered by the 6% return they receive from the company, the investor will net 1%. This means the majority of profit from the community business will not be reinvested in the community, instead it will be distributed to external financial institutions. This also applies to shareholders from the other community organizations options listed above. In essence, social capital is benefiting entities that, according to SE narrative, do not make any social contribution.

I view this scenario as an example of the natural conflict between for-profit and social motives where doing good cannot guard against compromise of social impact. When an opportunity to profit is added to the equation, individuals will take advantage of it at the cost of social capital.

I also would not describe this scenario as fitting into the common characterization of SE as the marketplace in this case is not open and unrestricted. Goods are being sold at a price not subject to market fluctuation and the environment is restricted as the type of entities eligible to sell the good is limited by government regulation.

One way to lower the potential amount of profit being distributed to non-community interests would be to connect charities, particularly private foundations, with this type of sustainable energy government initiative. The guarantee of profit may offer the opportunity for a foundation to add a 'community' business to their investment portfolios so long as it is considered prudent. This could be the type of 'social investment' the SE community envisions which will be examined next.

Part 10: **Social Capital Investment**

Overview

Author's note: This article uses the term 'social capital' to describe traditional support for charitable (public benefit) missions such as government and foundation grants, donations and volunteerism. Readers should note the difference between social capital and 'investment capital' - traditional business financing such as loans and share capital where investors receive interest payments or dividends in return for their investments.

Another cornerstone of SE is opening the apparently closed doors to socially conscious business capital investment; the doors being closed as charities have to operate in an unsustainable charitable manner and as non-share capital corporations are unable to pay out dividends. Private charitable foundations are viewed as a key source of investment capital given their obvious interest in public benefit missions but are supposedly inhibited by CRA policy and prudent investment rules.

Opportunities to invest in SEs would open the door to billions of dollars of social investment capital according to SE promoters although it is not clear whether this is investment from the public, corporations, government, or charitable foundations.

Also unclear is what constitutes social investment. Like SE, definitions and descriptions of social investment are ambiguous and broad, and investment can be directed to the full spectrum of legal entities and their activities. The concept of measuring social impact for capital investment purposes is also introduced, seemingly bridging the gap between traditional investment returns and traditional charity funding.

Like the allure of unrestricted profit, I believe unleashing capital for SE is a major contributor of the 'SE as a cause' influence on decision-making by stakeholders in and outside of the charitable sector.

What is a Social Investment?

Similar to SE, it is easier to characterize a foundational concept of social investment by what it is not - capital and financing, usually described as 'traditional investment', of a for-profit entity that does not make any kind of social distribution or contribution. Social investment directs investment capital to:

- registered charities
- NPOs
- co-operatives
- for-profit entities with public benefit missions
- for-profit entities involved in government regulated initiatives
- for-profit entities who undertake Corporate Social Responsibility (CSR) by voluntarily operating in an economic, social and environmentally sustainable manner

It seems that an investment in any of these organizations can be described as a social one. Similar to SE, trying to fit all of these under an umbrella term or fashion as a singular concept is a questionable exercise.

Corporate Social Responsibility

CSR is significant as similar to the broader and non-legal use of the term 'non-profit' in SE narrative, use of the term 'social' in investment narrative moves beyond describing an activity that may fall under one of four heads of charity. It is not clear what constitutes 'social' or, however it is defined, how a company is held accountable for operating in a such a manner and under what authority CSR designations are upheld.

Despite this, investment in these companies, referred to as socially responsible investing (SRI), seems to be viewed as an indicator of investor interest transitioning from traditional financial returns to ones that blend in social and environmental elements. As SRI is in the billions of dollars, this ostensibly means the potential investment market for SEs is just as high. This gives reason for the removal of the apparent barriers to entrepreneurial activity by charities where financial returns purportedly could be as competitive as returns from traditional investments or acceptably lower when a measurement of social impact is added to the equation.

Investor motivations

In general, I do not believe there is an extensive investment market for SEs that include a charitable or public benefit element such as provision of an essential good or employment of a marginalized population. SE promoters themselves admit will these types of SEs will struggle to compete with traditional businesses which in theory would limit capital investment.

Investors are motivated first and foremost with financial returns and likely would not choose any investment that will lower their returns regardless of potential social impact. This is not saying that an investor would not choose a 'social impact' investment; they would as long as their returns matched other potential choices. If returns are not competitive, individuals likely explore other avenues such as volunteerism or charitable donations in which to make a social contribution.

This also is not stating there are not wealthier investors who could afford to choose a higher risk investment or invest in a hybrid type entity where dividends would be capped. I do not believe this group has potentially large amounts of capital available to be moved into social investments without depleting contributions to other avenues of social change, namely charitable donations. In my opinion, this group would view making a social investment in the same light as a charitable contribution - a combination of a financial commitment and a sense of fulfilment - which, in essence, is a form of social capital.

What does not get mentioned in SE resources, or in general, is this group already has an opportunity to make a social investment in the form of a low or no interest loan to a registered charity. Perhaps this is the easiest path to move capital to public benefit organizations without having to revise CRA policy or create so-called hybrid organizations.

Aside from investor motivations, I do not believe it makes strategic sense to operate a SE as a business rather than a charitable program option or that the business would grow to a point where traditional individual or institutional investment would occur. This concept begs the question: if the market is responsible for creating social issues because it has fundamentally failed, as SE narrative seems to indicate, why would one look to the market to solve these issues?

This concept only seems to work if SEs are artificially supported by grants and donations but this would not solve the elementary problem of why the market created the community gap in service provision and barriers to employment in the first place - the natural conflict between for-profit and social motives. Even if investors were brought in, I would imagine their expectations, even reduced ones, would lead to social outcomes being compromised, a challenge also acknowledged by SE promoters.

I would take it a step further and question whether investment in these types of SEs would lead to a diminishment of overall social impact. Similar to consumers purchasing a fundraising good, investors would feel a sense of achievement from their investment which may affect their decision process when presented with another opportunity to support a social initiative. From a financial standpoint only, they are likely to be less enthusiastic to make a commitment than they were prior to making their social investment. This sense of accomplishment would not change, and potentially decreases, if the SE under delivers on its social impact.

In a larger sense, impact from available social capital from the community would be at risk of not being realized to its fullest extent and would be even greater if, as proposed by some SE promoters, private foundations were allowed to invest in non-qualified donees. Alternatively, if the social investment was made in the form of a PRI through a charity, financial risks and possible compromise of social outcomes are removed from the equation and social impacts would be fully realized. This seems to be a more effective way to direct investment capital to a public benefit mission.

SE promoters attempt to alleviate concerns of social capital risk through the quantification of social outcomes which will be examined in the next section.

Report on Mobilizing Private Capital for Public Good

Mobilizing Private Capital for Public Good: *Priorities for Canada* is a report by the MaRS Centre for Impact Investing issued in 2014. Its focus is on domestic policy in the context of developing the 'impact investment' market which includes SEs and businesses operated in depressed regions and by disadvantaged populations. Impact investment is positioned as different from SRI as it is intended to "achieve positive social outcomes".

Based on what appears to be anecdotal evidence of self-described SE activity by NPOs and registered charities, the report in-

dictates the Income Tax Act and CRA policy does not recognize the value of these activities and in some cases inhibits them, and has not kept pace with the trend of SE and impact investment. The report advocates for specific changes to CRA policy for registered charities regarding related business and the distribution of charitable assets to non-qualified donees, and to relevant provincial and/or federal prudent investment rules for private foundations.

Similar to other SE resources, the report's definition of SE is vague and includes the full spectrum of legal entities and activity. Also similar is a lack of content on the foundational concept of charity and, accordingly, any mention of policy regarding fee-based and employment-based charitable programs. Neither is there mention of CRA's position that SE is not considered a charitable purpose.

The characterization of impact investment is also indistinct and can seemingly be directed to the full spectrum of legal entities and activity. The argument for applying private foundation assets to impact investment (sometimes referred to as MRI or mission related investment) is based on what seems to be a faulty interpretation of CRA policy and the usual manner in which foundations operate.

CRA policy changes for business activity

One of the main premises of the report is to enable SE activity for charities as they purportedly have been engaged in "social entrepreneurship for many years". It is not clear what type of activities the report is referring to but one would assume it is activities other than clearly allowable ones like a hospital parking lot. This would be accomplished by expanding related business rules to include activities that:

- may or may not be allowed as "CRA guidance is unclear" including service-subsidized programs, job training, the sale of donated goods, rental of unused space, employment of marginalized persons, and fee-based charitable programs
- operate separately (i.e. separate employees and physical assets) within the charity to compliment an organization's revenue stream such as a hotel, a restaurant or a franchise

The former has been covered in Parts 5 through 8. With the possible exception of the sale of donated goods, there appears to be clear CRA policy for these activities that ensures appropriate stewardship of charitable resources towards public benefit. In contrast, the report implies a lack of regularity clarity and seems oblivious to the philosophical differentiation of business and charity. For example, the report identifies fee-based and employment-based charitable programs as businesses despite indication in CRA's policy **What is a Related Business?**, the policy that is proposed to be changed, they are not.

Furthermore, the report mentions SEs operated by charities would struggle to compete against for-profit businesses as they would have lower investment in technology and employee training, a workforce that includes marginalized persons, a consumer base that cannot afford to pay market rates for important services, and a reliance on potentiality untrained volunteer labour. For these reasons, the report states charities "would be challenged to develop a self-sustaining business model". This would appear to contradict the SE philosophy of financial sustainability and the report's claim charities have operated presumably profitable SEs for years.

If this is referring to SEs that provide an essential good or service and/or employ or train marginalized persons, there appears to be recognition that attempting to further charitable or public benefit purposes using a for-profit business model likely will not work. But rather than mentioning a charitable program option, it is argued the marketplace playing field needs to be leveled, seemingly justifying the use of social capital such as funding and donations. As has been mentioned throughout the article, this likely creates conflict with social outcomes.

The report also advocates for changes to the supposedly inhibiting **Subordinate** criterion in CRA's related business policy (discussed in Part 8) to allow SEs to receive more than "a minor portion of the charity's attention and assets". This seems like a clear example of the perception CRA policy is motivated exclusively by income tax concerns rather than serving to ensure appropriate stewardship of charitable assets. This is further enhanced by the report's consideration for for-profit business stakeholders to potentially perceive any policy changes as an "unfair competitive advantage through tax exemptions" ignoring the fundamental reason why charities receive tax exempt status in the first place.

In my opinion, good intentions aside, there is an elemental lack of awareness of the foundation of charity and its reflection in CRA policy. As arguments for policy change are based on what appears to be a misreading or a misconception of CRA

rules, their practical and strategic application lack plausibility. If a case was made questioning the fundamental conflict between for-profit motive and public benefit, this would at least present a starting point for discussion; so far none has been put forward.

Destination of profits test and related business

On the surface, the argument for complimentary business activity, a.k.a. profit-generating SE, appears to be based solely on the destination of profits test where a business activity that has no element of “public benefit objectives” in its actual operations, as per the report, directs profits towards public benefit. There does not seem to be a case made as to why a business would be a good option other than the potential for profit and the premise, a very shaky one in my opinion, charities have engaged in SE for years.

The risks associated with a charity operating a business from both an investment and social capital perspective, most notably the liability for business losses, has been covered extensively in this article. The question arises again of why one would look to business or the market to solve social issues when they ostensibly fail socially. The report introduces some specific points which require attention and make unrestricted business activity even more disadvantageous for registered charities.

The principle behind complimentary business is the enhancement of sustainability for charities - if a business can profit, the charity then has a stream of unrestricted revenue for its programs and services. The report states “while many businesses fail, this risk is outweighed by the benefits” and indicates this may open the door to a new class of donors interested in business development. To further the case for SE, the report also claims there are already risks current donations could be used to fund “unsuccessful programs” but gives no indication as to the context in which a program would be considered unsuccessful.

First and foremost, I do not believe charities expending charitable resources (social capital) to cover business losses would be accepted by the public in any context. That these losses would be offset financially or socially seems to be a very dubious and immeasurable claim. In my opinion, this alone overwhelmingly dictates complimentary business activity should be operated as a separate corporate entity.

A scenario that sees charities soliciting donations for their business puts social capital and donor relations at risk. As mentioned in Part 7, it does not make sense to filter social capital such as donations through a business where its impact is lessened and potentially negated if the business is not profitable. I see no reason to add ‘business development’ to the list of options offered to a very crowded donor market.

It is not clear what constitutes an ‘unsuccessful program’. It could mean an unsustainable charity program which relies on grants and donations rather than a program that charges a fee or is paid for by revenue from a profit-generating SE. It could also mean a program that affects limited change or has limited social return on investment (SROI), a concept which gets intertwined in SE discussion as it also promotes sustainability but in a different context. If it is the latter, there does not appear to be a guarantee programs funded by a profit-generating SE could not potentially be ‘unsuccessful’.

Whatever the context, the characterization of charitable work as unsuccessful and discouragement of donations to such work should concern charity sector stakeholders. Given the dynamics of SE, especially the lack of understanding of CRA policy by SE promoters and the use of ‘SE as a cause’ themed narrative, I do see how this type of claim serves the social sector in any respect. Some charities are already describing their activities as SE, and dependant on their interpretation of CRA policy, possibly risking their registration. Intimations that charities who do not undertake SE activity are somehow less effective will only push more organizations in a direction that is anything but clear.

Risk of charitable assets

Practical considerations aside, it is difficult to not question the foundation on which the proposed changes is based. In what appears to be a contradiction to the recommended changes, the report states charities incorporate separate entities “where appropriate to protect assets from business risk”. There is no explanation as to how a charity operating a complimentary business would be appropriately protected from risking its assets.

Perhaps it is because assets used in a complimentary business would be considered business assets (i.e. purchased with traditional investment capital), not charitable ones (i.e. purchased with or consisting of traditional funding and donations)

therefore a complimentary business and a separate for-entity entity are viewed the same, as are their respective assets. In theory then, charitable assets would not be risked in a complimentary business. Why a charity would decide to incorporate a separate business entity versus launching a complimentary business is not made clear.

It also does not seem clear there is recognition that when a business fails, it likely has lost money. If a charity operates a failed complimentary business, it would be liable for any losses which it would need to cover using its charitable assets; that the complimentary business is operated separate within the structure of the charity offers no protection. This means returns on social capital used to cover any losses would be nil.

This risk of business losses notwithstanding, it also is not completely clear assets used in a complimentary business would only be 'business' assets, not charitable ones. Along with soliciting donations for business development, the report also suggests charitable assets in the form of undesignated donations could be used to finance business activity in the same way donations are currently used to finance fundraising activity. As discussed in Part 9, these two concepts are given different regulatory treatment for practical reasons which seemingly negates the comparison. The ease of rules for charities to fund a separate incorporated entity, also advocated for in the report, also adds to the potential of charitable assets put at risk through business activity.

Even though a complimentary business would operate separately within a charity and would not have public benefit objectives, there is no guarantee traditional donations or even funding could not be solicited for a complimentary business given the ambiguousness of SE and its cause-themed narrative. As SE is promoted as having blended returns and sustainability, public benefit objectives could be presumed by donors and funders unaware of the intricacies of charity regulations. Their decision-making process could also be influenced by implications that charities not undertaking SE are inefficient or unsustainable.

Given the likelihood of numerous self-described SEs currently operating offside of CRA's related business rules, it is safe to assume that a number of charities themselves would be unaware that traditional donations and funding are not intended to be expended in a complimentary business SE. But whether they knowingly solicit social capital for their business or not, it would not matter as the charity would be dictated by the activity's for-profit intentions, essentially eliminating any reason to make that distinction. This would also bring about the other risks mentioned in Part 5 such as negative reaction from funders, donors and other charities if social capital is not being used as intended.

Commitment of resources

Another foundational argument for complimentary business is the time and money needed to establish a separate taxable entity that would include a separate board, financial management and administration. The additional expenses and drain on resources would preclude organizations, especially smaller ones, from incorporating a business. I would counter if a charity is going to undertake, as the report suggests, a long-term and potentially large commercial undertaking, not having the capacity and resources to establish and grow the business should raise an immediate red flag as to its success. If the business is going to be a sustainable venture, it does not make sense strategically to launch until the organization is ready.

The unfeasibility of incorporating a separate entity due to limited resource concerns is also questionable. The report indicates a complimentary business activity would be operated separately from charitable activity as it would have its own employees, financing, and assets. Similar to a corporate entity, this would require separate management, accounting, reporting, and administration. The report also indicates external reports on a charity's business activities for public consumption would also be required.* On the surface, costs to operate a separate corporate entity should not be that much greater than an internally operated one.

Risk factors aside, I would suggest operation of a complimentary business activity in a separate corporate entity should be a best practice. It would ensure organization readiness and eliminates the likely scenario of business matters constantly pushing aside charity ones on board and staff agendas.

The report also attempts to address potential concerns of mission drift - the risk an organization will spend most of its resources on running a business rather than advancing its public benefit mission. It is indicated the proportion of a charity's assets used for a complimentary business would be limited. This would appear to create complications for organizations that will only be able to deliver charitable programs if profits from a complimentary business are generated. In other words,

until it becomes profitable, the complimentary business will be using most of, if not all, of the charity's resources, and depending on the business, likely would continue to do so. Artificially limiting the size and growth of a business would not make strategic sense, another reason to establish separate entity.

** It also adds accountability and transparency concerns which will be discussed in the next section.*

Fundraising activity as a complimentary business

As discussed in Part 7, some promoters view fundraising as an example of profit-generating SE. Although the report does not mention fundraising specifically as a potential complimentary business option, based on its reference equating investment in fundraising with business investment, one gets the impression fundraising activity, particularly the sale of fundraising goods and services, could be viewed as a business activity or easily interpreted as such by public benefit organizations. There is opinion in the legal community some charities operate under the belief any activity that generates revenue including fundraising is "social enterprise" and is acceptable as long as it makes a profit.

There are already a few charities that describe their fundraising activities as SE seemingly to paint their functioning as business-like. The use of efficiency metrics beyond or in place of a fundraising revenue to cost calculation have been introduced to indicate how effective an organization is in generating revenue in comparison to others. This concept could be used to justify operating fundraising activity outside of CRA's Fundraising guidance; as long as a charity believes it is being proficient, any private benefit conferred is viewed as secondary or the cost of doing business.

This broadens the possibility of all fundraising activity, not just the sale of fundraising goods, being viewed as successful as long as business-like margins, i.e. surpluses of any amount, are being achieved. As this would include the solicitation of donations, the negative effect of operating fundraising activity outside of regulatory scope (mentioned in Part 7) is then magnified as receipted donations account for the majority of the \$30 billion fundraised annually by most of the 80,000 registered charities in Canada.

Impact Investment

Impact investment is described as embodying the following characteristics:

- *Investor Intention:* Investors expect a financial return and defined social impact
- *Investee Intention:* Business models for investees are intentionally constructed to deliver financial and social value
- *Impact measurement:* There is measurable social impact

Financial returns can range from below market interest rates to return of principal. Social impact can seemingly be measured in financial terms (profit margins from a complimentary business) or in social outcomes (e.g. the number of people who use an essential service), and can be any type of product from any type of organization within the full range of legal structure options. Business in and of itself is identified as a measured social impact and includes local or regionally-based businesses, and businesses operated in a depressed region or by a disadvantaged population such as First Nations or immigrants.

It can be in the form of individual or corporate investment in a for-profit entity, loans to NPOs and charities, government grants* and loans, investment by a registered charity in a SE operated by another charity, and if CRA rules were revised, unrestricted investment by a registered charity in a non-qualified donee. Social Impact Bonds are another potential impact investment option.

According to the report, impact investment "differs from the most prevalent forms of SRI in that it moves from negative screening (avoiding investments that do not meet certain environmental, social or governance criteria) to investment with the intention to achieve positive social outcomes." This would appear to differentiate businesses that integrate CSR into their corporate agendas from organizations that have formal public benefit missions or state as such.

** Unlike traditional charity grants, these are offered under the guise of SE or business development.*

How does investment impact translate to the charitable sector?

An attempt to answer this question would bring about the same content put forth already in this article and would reach the same conclusion - with confliction.

In my view, impact investment has a similar level of ambiguity and the seemingly unquestioned association to achieving social good as SE. It attempts to fit different types of investment and financing under an umbrella term despite different investee intentions. Its vagueness allows for similar cause-type narrative such as “many impact investments are prudent by traditional investment standards” with no qualification as to the type of activity in which the investment was made.

Investee options for impact investment have been examined in detail in Parts 5 through 9 where potential risks to social and/or investment capital have been identified. The potential for business activity to impact communities was also discussed along with appropriate methods to promote this concept through tax incentives and targeted financing rather than use of social capital.

It is worth noting again the only organizational structure that is intentionally constructed to steward social capital towards public benefit is a registered charity. As mentioned throughout the article, adding or blending an element of private capital with its expectation for a specified financial return can potentially compromise social outcomes as legal structures other than charities lack the mechanisms to guard against this occurrence. Despite this dynamic, the report attempts to cross the divide between “charitable granting and financial investment” through the concept of measuring and monetizing social impact.

Quantifying Social Outcomes/Social Return on Investment (SROI)

A common definition of SROI is “an approach to understanding and managing the value of the social, economic and environmental outcomes created by an activity or an organization. SROI measures the significant intended and unintended outcomes and applies a dollar value to those outcomes.”

In general, the quantification of social outcomes is a way for an organization to indicate the social change it has affected on others by measuring social outcomes. It answers any questions as to whether an investment* of social capital is making any difference such as increased employment or use of an essential service. If a monetary value can be assigned to those outcomes then a ratio of social value to investment (social capital) can be calculated.

A common illustration of SROI is measuring the recidivism rates from a program designed to keep ex-convicted criminals from reoffending and putting a dollar value on the costs associated with a return to incarceration, \$100,000 for example. For every program participant who does not reoffend, this figure is added to the total social value of the program since \$100,000 would not have to be expended on that individual. SROI would be this total less the program costs. For example, if the program cost \$1,000,000 and had 30 participants who did not reoffend, SROI would be \$2,000,000 (30 x \$100,000 less \$1,000,000) and the SROI ratio would be 3.0 (30 x \$100,000 /\$1,000,000).

One of the main premises of SROI is the measurement of social outcomes. This differs from traditional charitable programs or, more aptly, the regulatory environment in which they operate, as accountability mechanisms for registered charities, despite being public benefit purpose-based, do not require quantification and reporting of outcomes. For example, if the above noted program is operated by a charity they would not be required to measure recidivism rates in order to be compliant with CRA policy. As long as the charity’s resources are being appropriately allocated to efforts towards the program, whether recidivism rates are affected positively by the program or not is not relevant from a compliance perspective.

If the program is not making a difference then the thinking by SROI advocates appears to be it is not sustainable and is an inefficient use of social capital. Alternatively, a system that does measure recidivism rates is positioned as being more effective and organizations that report outcomes are positioned as affecting sustainable change.

** The ‘investment’ in SROI is not necessarily referring to traditional business investment such as loans and share purchases. More than likely the ‘investment’ is in the form of traditional charitable funding and donations and can be referred to in social sector narrative as ‘social investment’ or ‘social capital’.*

Equating SROI with traditional business investment

The quantification of social outcomes seems to be viewed as:

- (1) A way to differentiate between social programs that have little or no impact and those that do. The former can be labeled as ‘charitable’, adding to the portrayal of charity as unsustainable. The latter can be labeled as ‘sustainable’, adding to its prominence in SE and social investment resources.

(2) An avenue in which to look at social impact delivery as a business where SROI is treated like traditional financial returns. In theory, funders can make funding decisions based on SROI and, accordingly, social investors can make investment decisions based on a combination of financial and social returns.

While it is reasonable to expect a program funded by social capital to have impact and no one would dispute funneling funds towards programs that are making a difference, with the introduction of a for-profit dynamic, in this case the use of private capital, I am not certain this concept guards against potential compromise of social outcomes. The idea of measuring SROI on its own does not appear to be unreservedly accepted by social sector stakeholders and applying it for funding or private investment purposes is cautioned as it adds pressure to achieve certain outcomes to appease investors and funders. The most common concern is 'creaming' – organizations selecting the candidates most likely to succeed at the cost of inclusiveness.

The diversity of deliverable public benefit would seem to make the application of SROI for impact investment purposes unrealistic and potentially exclusive. The obvious question is can all social outcomes be measured and monetized? For example, can a dollar figure be applied to the outcomes of an accessible transportation system or an employment program for persons with disabilities or an animal shelter? If not, does this mean they cannot access the impact investment market?

If a SROI can be calculated, can it along with the SROI ratio be used uniformly to differentiate one SE from another; in other words, would a higher SROI ratio be automatically deemed better? How could one compare the SROI of rescued animals against the number of people using accessible transportation to determine which one is more impactful? It does not seem practical to compare the outcomes from organizations with vastly different public benefit purposes.

Accountability and Transparency

Even if a uniform SROI could be developed, potential funding and capital directed towards impact investment likely adds a competition dynamic necessitating the need for accountability and transparency stipulations more onerous and costly than CRA's.

There is a growing trend of charities attempting to garner donor interest by positioning their fundraising activities as being efficient in terms of revenues to costs despite the lack of a formal efficiency measuring system (CRA's Fundraising guidance does use the term 'efficiency' but measuring efficiency is not part of their evaluation process i.e. lower fundraising cost to revenue ratios relative to others are not gauged as better). Efforts by charities to present their fundraising activities as meeting supposed sector standards or more efficient in comparison to other charities could be construed as deceptive and offside of CRA policy. If they are combined with incorrect categorization of fundraising revenues and expenses on the T3010 Information Return, a frequent occurrence for many charities which in itself is potentially deceptive, the risk of non-compliance becomes greater.*

Efforts to attract or appease impact investors likely leads to the same practice - organizations portraying their impact in as positive light as possible when compared to potential competitors or sector standards even if there is not an established standard to be measured against. On the surface evaluating social impact would seem to be much more complex than the identification of fundraising revenues and expenses; it would be just as challenging, and likely more so, for organizations to report impact accurately according to any guidelines.**

Incorrect financial reporting can also be the product of another common occurrence in the charitable sector - assumptions or misinterpretation of CRA policy specific to revenue generating activity. The misconception that a charity can profit from any activity or a 'social enterprise' as long as surpluses are put towards a good cause can lead to the categorization of expenses associated with those activities as related to charitable activities, not fundraising, on both financial statements and the T3010.

This can be exacerbated by the capacity of CRA to uncover incorrect T3010 revenue and expense reporting as they usually only audit about 800 charities per year (out of 80,000), an even lower amount of which would be random as some are a result of investigations into formal complaints. Knowingly or not, a charity could be misreporting financial information many years before being made aware by CRA.

I believe there is little doubt social impact would need to be carefully measured by an independent party to ensure an equi-

table system involving costly and burdensome accountability requirements, much greater than what is currently required by CRA for registered charities.

** The reporting of other fundraising metrics noted earlier likely sees the same trend except there is not a supposed regulatory standard to reference.*

*** The same can be said for the external business reporting requirement that would accompany the report's suggested changes to CRA's policy for related business.*

Impact equals sustainability?

If measured social outcomes do not necessarily have to be monetized to make an impact investment, which seemingly would be up to the discretion of the investee, then another issue, perhaps the most important one, materializes - a foundation in which to establish acceptable social returns. Will any level of social impact will be considered sustainable as it is better than no impact at all?

In the case of businesses operated in a depressed region or by a disadvantaged population, any increase in business activity will be considered impactful for the assumed social benefits that accompany it. For SEs that include a charitable or public benefit element, any increase in the employability of marginalized persons or use of an essential service may be considered similarly impactful. There does not appear to be an obvious or natural method to indicate when measured social impact would be considered unsatisfactory.

For example, an impact investment of \$100,000 is made in ABC Charity to purchase the vehicles needed to deliver its affordable and accessible transportation service. The investor is satisfied with a below market rate of interest and the measured social impact will be the number of users of the service. The estimate of the 500 people in need of the service in the community is not necessarily identified in this arrangement. As any usage of the service potentially could be viewed as making a sustainable difference; the investor will likely be satisfied with a significant amount of service users as their investment has then made a measurable social impact.

This would give flexibility to ABC Charity to not necessarily make the service as affordable and accessible as possible or even identify the number of people in the community who could benefit from it. They may determine serving a lower number of clients or limiting the availability of the service is the better scenario financially to generate the surpluses needed to cover interest payments. A reliance on surpluses from the transportation activity to fund other ABC Charity programs could also be a factor. Trying to serve as many of their clients as possible may not even be a reasonable consideration for ABC Charity if, in vying for interest from impact investors, they feel the need to offer higher financial returns than their competition in the impact investment marketplace.

Even more concerning is the operation of this activity by a non-charitable entity where private gain becomes an incentive which can undermine social outcomes. SE narrative makes it clear financial gain is one of the motivations for social entrepreneurs, private financial goals may move consideration for accessibility lower on the SE's list of priorities. Regardless of legal structure, the reality of simply keeping the SE out of the red could force social outcomes to be lowered.

The lack of a natural breakeven point for acceptable for social return brings up two key questions:

At what point does an investor pull out of an impact investment?

As long as interest is being paid and social impact is occurring, does the investor care or even know on what basis to make that decision?

This means ABC Charity's impact investor could be satisfied with their investment even though a considerable number of the estimated 500 people in need cannot afford or access the transportation service. In SE terms, 'market improvement' for an essential service could be minimal or minimized and the needs of some will continue to be 'unmet'.* If a non-charitable entity is operating the activity, private benefit at the expense of public benefit becomes a possibility. In SE terms, the influence of 'traditional marketplace' motivations would be a hindrance to 'market improvement'.

** Referenced in Part 5 - a SE motivation is 'market improvement' that meets a 'need which is unmet within the traditional marketplace'.*

The sustainability of revenue generating charitable programs

What gets lost in the SROI discussion, or more likely is not realized, are fee-based and employment-themed charitable programs have social outcomes embedded within their operation; they cannot be delivered without increasing the employability of marginalized persons or use of an essential good or service. This means they are sustainable in the context of measured social impact, and even better, due to stewardship by CRA policy, the effectiveness of social capital is maximized.

For example, if ABC Charity's transportation program was offered for free to its clients, social outcomes (usage of the service) could be minimal but unless the funder/donor required a certain amount of service usage, the program could operate without concern from CRA even though the vehicles are being underutilized or not used at all. If the program was fee-based, then ABC Charity would need to estimate the number of clients who would use the service before investing any of its assets in program infrastructure, and whatever the estimate, the requirement to defray costs would ensure no social capital is used needlessly or ineffectively. If this was recognized, I believe it would be better understood that an alternative to an impact investment would be a program related investment (PRI) made by a charity.

In ABC's Charity case, a PRI would be made with the expectation the transportation service will be as affordable and accessible as possible to the 500 people identified in the community who could benefit from the service. As financial returns for a PRI are appropriately secondary to social outcomes* rather than being equal or blended, ABC Charity's obligation to cover interest payments and return the principal will not affect their efforts to serve as many clients as possible. If the ultimate goal of applying impact investment to the delivery of public benefit is to ensure social investment makes a difference, then a PRI in a charitable program would be the best option to ensure social outcomes are maximized.

Also of note is use of assets in a PRI would be considered program related and not included in a charity's disbursement quota calculation. This is relevant as the report appears to equate PRIs and impact investment the same as traditional investment, where a charity, most notably a private foundation, places assets which are not currently needed for charitable purposes. This is used to create a false dichotomy of foundations sitting on billions of dollars of capital that could be used in a more socially effective manner. It is false as use of foundation assets on impact investment or a mission related investment (MRI) should be considered similar to making a grant or a PRI - a use of social capital. Therefore an impact investment would affect a foundation's ability to commit assets to other social interests. This will be examined closer in the next section.

** In CRA's words "A PRI is not an investment in the conventional financial sense. While PRIs may generate a financial return, they are not made for that reason. A PRI usually involves the return, or potential return, of capital (funds or property) within a set period of time, but this is not a requirement."*

Private Foundations and Social Capital Investment

Generally, a private foundation is established to fund qualified donees who usually are other registered charities. Foundation capital is built through donations and typically grants are given out on an annual basis from the interest and dividends earned from the foundation's investment portfolio. The usual strategy is to keep the principal amount of capital intact so funding can be provided in perpetuity.

Similar to investments made by individuals, a private foundation's portfolio will be comprised of investments designed to fit its specific investment goals with the expectation from CRA they will represent "a prudent use of the charity's assets." In CRA's words "charities need to invest their capital and any funds not required for their current operations. Charity law dictates that a charity's assets be managed so as to obtain the best return within the bounds of prudent investment principles." In other words, charities should not risk assets by investing for reasons other than seeking market returns for capital.

For example, if a charity receives a major gift for a new building that will not be built for five years, it is expected they would invest the funds in a manner that appropriately protects the principle amount until it is needed. This could be a very low risk investment such as a GIC. Investing in higher risk investments such as equities likely would not be considered prudent regardless of the fact it may return a rate higher than a GIC. Conversely, not investing the funds in any kind of interest bearing investment may also not be considered prudent as the charity would not be seeking market returns.

As noted above, a PRI would be considered property used for charitable activities. Despite the inclusion of 'investment' in its name, it would not fall under prudent investment rules.

To ensure tax-receipted donations have the designed benefit to the public, private foundations must meet CRA's disbursement quota (DQ) which stipulates they spend on an annual basis at least 3.5% of the value of their property not used for charitable activities or administration. The DQ guards against foundation funds simply earning interest and/or dividends rather than being used to forward charitable purposes, presumably the reason why the foundation was formed and given charitable status in the first place. There is no reason to believe private foundations choose to only disburse enough funds annually to meet the 3.5% minimum.

An example - MNO Foundation

MNO Foundation has \$1,000,000 in assets in a bank account earning 4% interest. These assets are not considered used for charitable activities or administration therefore they must spend at least \$35,000 to meet the DQ. If they used half of their assets (\$500,000) for a PRI, then the amount of property not used for charitable activities or administration is reduced to \$500,000 and accordingly their DQ is reduced to \$17,500.

It is recognized that a PRI may receive less than market rate interest so CRA may give consideration to "any opportunity cost resulting from these activities as equivalent to expenditure." If MNO Foundation makes a PRI of \$500,000 which only earns 2% interest (\$10,000) rather than the 4% interest (\$20,000) it could have earned if it stayed in a bank account, the difference in interest (\$10,000) may be considered in the DQ calculation. I.e. the DQ could be further reduced to \$7,500.

This seems to be a reasonable assessment of the nature of using charitable funds in a PRI. There is acknowledgement that a PRI serves charitable purposes and, unlike traditional investment, may show less than market returns which is factored into its regulatory treatment. There does not appear to be any limitations on how much of its assets a private foundation could use in PRIs, save for limitations on share purchases*, which in my view is very enabling for sustainable fee-based or employment-based charitable programs. I see it as the medium for social investment the SE community appears to be seeking. Conversely, SE promoters appear to think they do not go far enough due to their limited reach to charitable purposes only and their potential discouragement by CRA policy due to prudent investment rules**.

* *Registered charities designated as Charitable Organizations do not appear to have any restrictions on share purchases.*

** *Narrative in another MaRs report suggests "Canada Revenue Agency should clarify its formal guidance to foundations to eliminate any misperception or uncertainty around whether foundations are discouraged from making mission and program related investments."*

Impact investment and private foundations

In the report, there appears to be a misconception of private foundations based on a number of suppositions:

- (1) Despite an indication in the report of PRI's being "primarily focused on advancing charitable purposes", assets in a PRI are considered a type of investment and are included in the DQ calculation (use of the word 'investment' in PRI may be a contributing factor to this). In the above example, this means even if MNO Foundation makes a \$500,000 PRI, they are still considered to have \$1,000,000 worth of property not used for charitable activities or administration.
- (2) Foundations only disperse enough grants annually to meet the required 3.5% DQ. All other foundations assets are generally invested with "the sole aim of maximizing financial returns".
- (3) Rather than ensuring charity assets are protected from inappropriate or inefficient investment practices, 'prudent' investment is viewed as maximizing financial returns through traditional investment.

From these interpretations, it is established private foundations are sitting on capital that ostensibly is not serving any purpose other than earning market investment returns required by 'prudent' investment standards. This apparently underutilized capital could be used for social impact if prudent investor rules were changed. The report proposes the use of private foundation capital on investments other than traditional ones and uses PRIs as an example of how an investment that is not 'prudent' i.e. shows little or no financial return, can ultimately serve a foundation's charitable mission.

As mentioned above, there is no reason to assume private foundations limit their granting programs to simply meet the annual 3.5% DQ. Neither is there reason to believe investment strategy decisions are based on maximizing returns rather than serving a foundation's specific goals.

Directing capital from traditional investment to impact investment where returns are potentially lower affects a foundation's ability to make grants or a PRI. Rather than being viewed as an opportunity to put unneeded capital to use, it should be viewed as an alternative use of assets for charitable activity; an alternative that introduces potential financial and social capital risk.

For example, with no PRI, MNO Foundation annually dispenses \$40,000 in grants from the interest it earns from the bank account. With the \$500,000 PRI earning 2% interest (\$10,000), the amount available for grants is reduced to \$30,000 (\$20,000 from the bank account plus the \$10,000 from the PRI) but the \$10,000 decrease is offset by the social outcomes of the charitable program in which they made the PRI. If the foundation makes an impact investment of \$500,000 instead of a PRI which also pays interest of 2%, the amount available for grants is reduced by the same amount to \$30,000 but, as noted above, the offsetting social outcomes could be compromised. In my view, this is why a PRI in a charitable program would be the best strategic option for a socially-minded investment, and where charitable assets are concerned, the only option.

Practical considerations aside, it is worth noting the credibility of the report's recommendations again comes into question as it seems clear a fundamental understanding of charity is lacking. Most notably is the belief a PRI is an investment option rather than a charitable asset and, even with this distinction, does not appear to have a place in a foundation's portfolio due to its charity-only focus.

While PRI seemed to be viewed the same as impact investment or MRI in so far as they are both alternatives to traditional investment, the report does not distinguish between the focus of a PRI - advancing charitable purposes - and the focus of an impact investment - measured social outcomes. PRIs appear to be viewed differently from impact investment simply by the inclusion of the term 'charitable' and its connotation of unsustainability thus are not explored as a viable option for, or an alternative to, impact investment.*

This is confusing as the report proclaims revenue generating charitable activity that directly advances a charitable purpose, i.e. a fee-based charitable program, is business activity and an option for impact investment. So while a charitable-purpose activity can apparently achieve both financial and social returns, it apparently cannot be supported by a charitable-purpose focused investment like a PRI. This begs the question of the context in which a charity would make a PRI if not in charitable programs.

** Another MaRs initiative - an impact venture fund - supported in part with charitable assets invests in for-profit companies only. Registered charities are not eligible despite the opportunity a PRI offers.*

Use of charitable assets by non-qualified donees

The report's relative equation of impact investment with traditional investment is taken further to validate the transfer of charitable assets to non-qualified donees. Since foundation investment portfolios are composed of non-qualified donee assets such as GICs, mutual funds, and equities, the report proposes impact investment could similarly be made in non-qualified donees.

This idea could also be based on the U.S. model for Program Related Investment (the report includes a reference and interpretation of U.S. policy) although it appears to mirror CRA's model in both name and regulatory treatment. Most notably, the U.S. version also treats a PRI as a program related use of charitable assets and would not be included in a charity's disbursement quota calculation.

Despite this, in what seems to be construed by impact investment promoters as a notable difference, the report states recipients of a U.S. PRI do not have to be charities themselves and can include "non-profit or for-profit organizations or individuals" although there is a stipulation that charitable foundations "must exercise expenditure responsibility" to ensure charitable purposes will be accomplished by the PRI.

CRA policy on this same subject stipulates a PRI must be made to:

- a qualified donee; or

- if the recipient is a non-qualified donee, the PRI must be used for a program over which the investor charity maintains ongoing direction and control, so that the program is the investor charity's own activity

The latter usually means the non-qualified recipient will act as the intermediary for the investor charity.

In my opinion, the rules for both models of PRI recognize non-charitable entities have different intentions and lack the appropriate regulatory oversight to steward charitable resources towards public benefit. Conversely, the report's recommendations do not appear to propose any kind of control over charitable assets directed to NPO's, co-operatives, or for-profit businesses as the requirement for a charity to maintain direction and control is described as "impractical". I would again attribute this contradictory view to a lack of awareness of CRA policy and the lack of distinction between charitable purposes and social impact.

Although CRA is clear a charity cannot use a PRI if it cannot maintain direction and control over the activity carried out by a non-qualified recipient, a charity "could potentially invest in, or provide resources to, the non-qualified donee at market rates (as a form of conventional financial investment) provided the investment meets the investor charity's conventional investment requirements." This means charities could invest in the "many impact investments" mentioned in the report that show traditional market rate returns. They could also potentially invest in 'community' businesses (ones involved in government sustainable energy initiatives) discussed in Part 9.

Opportunities for socially conscious investors

Despite the SE community's apparent belief to the contrary, I would say the doors are already open to capital investment for social (public benefit) impact that offers investors the combination of financial benefit and the fulfillment of doing good. This includes the full scope of financing options such loans, loan guarantees, leases and share purchases.

The last one is of particular significance as community shareholder ownership seems to be a keystone of SE philosophy. Although charities themselves cannot issue shares, a shareholder relationship can exist where investment capital is directed to public benefit purposes and an appropriate reflection of financial benefit is bestowed upon the source of the investment capital. This can be achieved as follows:

- an individual makes a charitable donation where the funds are used to make PRI
- the PRI is in the form of a share purchase in a non-qualified donee such as a for-profit corporation
- the PRI will allow the corporation to operate a public benefit activity over which the charity maintains direction and control
- instead of private individuals benefiting from holding shares in the company, the public benefits
- instead of the individual investor benefiting from traditional shareholder returns like dividends, they receive a tax receipt

Loans, another common financing tool, can be similarly played out affording the same public and 'social investor' benefits. Other key SE objectives such as supporting entrepreneurship and removing employment barriers for the marginalized can also be 'invested' in by individuals via charity programs mentioned in Part 6 such as SBFIDs and OTJT, and Individual Development Accounts (IDAs). The investments would not have to necessarily be PRIs, it could be in the form of grants or program delivery which would not affect the end result of dual benefits

The door is also open and has always been for individuals to support marginalized communities through business activity or local business ownership via the traditional investment route. That investment capital does not move in that direction is a reflection of marketplace indifference to social concerns but this can be improved by the introduction of targeted investment incentives and charity/business partnerships.

An investment in a deprived area is also available via the charity route in certain circumstances such as employee training. As is investment in other charitable CED activities such as those that promote commerce or industry as long as those activities, in CRA's words, "focus on enhancing an industry or trade as a whole for the benefit of the public".

Between PRIs, prudent investments, and charitable CED activity, it would seem there are numerous options for 'social' capital investment; ones that would offer, to use the SE term, blended returns and would be free of risk to social outcomes.

Part 11: **Non-charitable Entities and Interests**

Overview

The article's primary focus to this point has been on issues created from the conflict of SE and registered charities, the main ones being:

- inequitable distribution of government and foundation funding
- an increase in competition for fundraising dollars through activities operated outside the scope of CRA's Fundraising guidance
- the use of social capital (funding, donations, and volunteerism) to fund business ventures and cover business expenses

The inclusion of non-charitable entities (NCEs) as deliverers of social impact and recipients of social capital adds to these concerns and is amplified given these entities do not have external public benefit purpose-based accountability mechanisms in place and private benefit has no hard stop.

According to SE narrative, the full scope of legal entities including NPOs, co-operatives, and for-profit entities including hybrid organizations can deliver social impact. As they are free of the purportedly restrictive environment and approach in which charities operate, they are viewed as being more sustainable and efficient.

This can affect the charity sector on three fronts:

- (1) Charitable assets being transferred to NCEs.
- (2) Social capital being afforded directly to NCEs.
- (3) Charities frozen out of accessing social capital.

This opens the door to for-profit activity with potentially compromised social impact. This should cause consternation to charity sector stakeholders as social capital is not being used to its full effectiveness, possibly ending up in the hands of private interests. As should the possibility of government social capital being directed to NCEs instead of charities, charitable foundations directing their assets exclusively to for-profit entities, and the replacement of traditional government funding with the availability of investment capital for SEs.

The emergence and promotion of hybrid organizations as an evolution of charity reflecting modern trends also needs attention in this discussion as, despite best intentions, potentially diverted social capital is not suitably safeguarded.

Charitable Assets Transferred to NCEs

Aside from the CRA policy changes proposed by SE promoters that would allow charities to transfer assets, most notably those of private foundation, to non-qualified donees, there are a number of other avenues in which assets could be, or appear to already have been, transferred to NCEs:

Registered charities operating a SE grant program: Grant money is offered to organizations, usually limited to registered charities and NPOs, that self-identify themselves or one of their activities as a SE. Some charities grant directly to NPOs; others, in apparent recognition of CRA policy, indicate an NPO would need to be 'sponsored' by a qualified donee who will serve as the formal recipient of the funding but will subsequently transfer the funds to the NPO.

Unless the NPOs are carrying out charitable activities of either the funding charity or the sponsor charity as part of a formal intermediary arrangement, this likely is offside of CRA policy. It states "a registered charity is not permitted to carry out its purposes by simply handing over its money or other resources to an individual or to another organization that is not a qualified donee. Gifting to a non-qualified donee will put the registered status of the charity in jeopardy."

Charities need to be aware they are accountable for any disbursement of its assets, even to an NPO with a public benefit mission similar to their own. As noted in Part 2, regardless of their stated purposes, NPOs do not have the same level of external scrutiny.

Funding of a separate taxable corporation: A registered charity that is self-identified as a SE opts to incorporate a separate entity in which to operate a business not allowed under charity law. It transfers funds to the entity on the pretext of collateral social impact from the operation of the business. Along with being a questionable use of social capital, this likely would be considered conferring a private benefit on the corporation as per CRA policy.

Investment in for-profit companies: Registered charities making capital investments in for-profit companies under the guise of impact or mission related investing already appears to be taking place. Only for-profit companies are eligible for investment despite the opportunity a PRI offers. As these investments may not represent a prudent use of a charity's assets, social capital is at risk in the form of the charity's diminished ability to support its own charitable purposes or support the purposes of another charity through grants or a PRI.

Even if related business rules were changed as proposed in Part 10 to open up opportunities for impact investing in registered charities this still could exclude some charities from accessing social capital. Organizations that are unable to quantify their social outcomes in monetary terms may not generate investor interest.

Other scenarios where an unacceptable private benefit can occur that fall within the theme of SE are charities promoting entrepreneurship by helping entrepreneurs bring new and innovative ideas to the marketplace and promoting business development by providing funding (including start-up loans), and mentorship programs. Describing it as 'social' entrepreneurship or promoting 'social' or 'community' business development likely does not change CRA's assessment as community economic development (CED) or other associated terms like SE are not recognized as a charitable purpose.

Another common scenario is registered charities using a SE grant to pay for business feasibility studies and business consulting to support the development of a self-described SE. Charities have to ensure these expenditures are on an activity that falls within the scope of achieving their charitable purposes. For example, if ABC Charity uses a grant to help establish a charitable fee-based transportation program, this likely is in compliance. If they use the grant to pay for a feasibility study on establishing a for-profit transportation service, this likely falls outside their charitable purposes and they have conferred a private benefit.

This particular situation can be frustrating for registered charities as the introduction of SE funding programs, the focus on SE by various government agencies, and the virtual entrenchment of SE in social sector dialogue all seem to indicate broad promotion and support for SE. It is completely understandable charities would want to further their missions by taking advantage of funding opportunities when presented .

SE Promotion

The spectrum of organizations who promote SE is as varied as the spectrum of organizations who can seemingly operate SE. It includes charities, NPOs, and government agencies, all of whom are assumed to have no other mandate than to seek social impact through SE.

Also included in this group are for-profit entities that offer SE development services thus have a private interest in charities and NPOs undertaking SE activity. These entities are not accountable to any mandate other than their business agendas which, in my opinion, puts them in a conflict of interest position on the topic of compliant activity by NPOs and charities. I would consider any implications by for-profit promoters that SE activity is or should be allowed to be inappropriate and ethically questionable. I would caution charity sector support organizations and government agencies giving them platforms in which to promote SE and the appearance of credibility that goes with them.

This should not be viewed as an indication their intentions are not to try to 'do good' but rather recognition that a for-profit motive effectively renders their intentions a moot point and that no one should be above reasonable accountability and transparency. Even though I believe I have good intentions as a consultant, I am careful in making any remarks about the regulatory environment outside of my professional capacity even if it could enhance my business. I would not knowingly push an organization in a direction that could create compliance issues regardless of my opinion of the rules or my well meaning intentions. In my view, the lack of understanding by SE promoters of CRA policy and the 'SE as a cause' factor contribute to this scenario.

Regulatory Oversight

The reality for registered charities is despite intimations from any group promoting SE, and regardless of activity undertaken

by government agencies besides CRA and even by other charities, it is up to each individual organization to ensure their activities meet CRA criteria for continued registration.

Along with seeking appropriate CRA or legal guidance, I would suggest to charities to also consider any SE idea, especially ones that include a public benefit element, from a strategic perspective before committing resources and seeking potential funding or financing. This will provide the optimum direction for the organization to forward its charitable purposes and ensure efficient usage of social capital.

A common complaint from SE promoters is the lack of support and direction from CRA about SE activity and the cost of legal fees to get proper guidance; a cost many organizations cannot afford. CRA has given direction by referencing the SE concept in its guidance on **Community Economic Development Activities and Charitable Registration**. Their position that SE “has not been recognized as a charitable purpose in Canada” is, in my opinion, an accurate reflection of its ambiguity. As the SE concept appears to conflict with the philosophical foundation of charity, the necessity for legal assistance is also an accurate reflection.

There needs to be recognition that well over one hundred billion dollars* is directed to registered charities each year through funding and philanthropy to meet public benefit missions. Social capital is directed towards charities because of the public’s high level of trust in the sector due in part to the stringent regulatory environment in which they must operate.

Registering and operating a charity is a major commitment requiring appropriate governance including comprehension of and compliance with the rules in place to guard against any misuse of what essentially are public funds. Any deterioration of public confidence would affect the charity sector’s ability to deliver impact. If CRA policy is difficult to understand without legal guidance and compliance seems overly burdensome, blame should be directed to individuals who attempt to abuse the system. In order to maintain a high level of trust, CRA has no choice but to introduce policy and accountability measures that protects charitable assets.

In my opinion, organizations that circumvent the rules, knowingly or not, can also contribute to this. It seems to be a commonly held view in the social sector legal community, and acknowledged by SE promoters, that a number of organizations are operating on the ‘destination of profits’ premise - anything they do to make a profit is acceptable as long as profits are used to fund their programs and services. As trying to profit in any context introduces risk factors, CRA policy must be thorough to avoid any grey area interpretation.

If the cost of registration and appropriate governance is too much for some, as mentioned previously, perhaps individuals and groups should consider partnering with an established charity. Or the development of umbrella-type organizations that lessens administrative responsibility could be encouraged within the sector.

** This figure excludes the \$100 billion or so directed towards non-core charities such as hospitals and educational institutions.*

Social Capital Afforded Directly to NCE’s

A few scenarios where social capital can be, or likely has been, given directly to a NCE have already been identified:

- NPOs with public benefit missions fundraising outside of the scope CRA’s Fundraising guidance. This can potentially lead to a majority of raised funds ending up in the hands of organizations or individuals who are not ‘the cause’
- NPOs with public benefit missions operating a self-described SE and receiving government funding which, depending on how SE is interpreted, can put social capital at risk

Other scenarios include:

Government SE Grants: Funded by a provincial agency, grants are offered to charities but also to NPOs and co-operatives presumably as these organizations also earn ‘social’ profits. For-profit entities are not eligible to apply. The inclusion of co-operatives means social capital could be used on for-profit activity where no public benefit would be achieved.

Government-backed loans for SE: This is a program that offers government guaranteed loans to organizations to launch a SE. Examples of potential SEs include “local daycare, transportation system for seniors or persons with disabilities, recycling depot, homecare and healthcare services.” Despite a registered charity being an option to operate some of the listed exam-

ples and the only one accountable for operating in an exclusively public beneficial manner, they are not eligible to apply, it is limited to for-profit entities and NPOs without registered charity status. According to the loans program administrator, the reason for the exclusion of charities is they only are able to operate using grants and donations. I see this as a clear example of the misunderstanding of charity and a lack of awareness of the legal environment for NPOs.

Corporate grants - A funding program designed to affect social and environmental change including employability of disadvantaged populations. Only for-profit businesses are eligible to apply despite the opportunity for a charity to operate an employment-based charitable program where inclusiveness would not be potentially comprised.

Support of businesses with collateral social impact - Government and corporate funding and financing to for-profit entities operated by or in marginalized communities under the presumption economic spinoffs or increase in employment has public benefit. As discussed in Part 6, public benefit in marginalized communities can be achieved through charitable programming without the potential conflict of business operations.

Charities frozen out of accessing social capital?

These scenarios are another reason why organizations that support charities should be cautious of giving credibility to SE. As this effectively equates the social impact of SE the same as charities, social capital can be diverted away or, as illustrated, not even be within the sector's reach.

Despite assurances by promoters that SE and impact investing are meant to compliment, not replace, traditional charitable programs, funding, and philanthropy, the nebulous way in which SE can be interpreted by various government agencies with different mandates and by corporations with business mandates opens up the possibility of them directing social funding away from the charity sector. The 'SE as a cause' factor can play a major role as government agencies perhaps want to appear they are 'on board', even more so for corporations as public relations and marketing will always be incorporated into their decision making.

Another possibility which would negatively affect charities is the replacement of traditional government funding with capital and financing tools for SE. As promoted in the **Mobilizing Private Capital for Public Good** report, public benefit can seemingly be achieved if investment capital (loans, share purchases, mortgages, etc.) was made available. Narrative about the sustainability of SE and 'unsuccessful' charity programs could easily sway government and corporate decision makers who are not required to understand the nuances of charity regulations. As can the credibility afforded to SE and SE promotion by charitable sector support groups and agencies.

Charity Support Organizations and Agencies

Organizations, sector councils, and government agencies whose mandates support the work of registered charities can contribute to the NCE dynamic by giving SE creditability. On the surface, SE seems to be a great fit with the mandates of these groups as SE is viewed as a cause unto itself and equated with the work of charities. This can create the impression to external stakeholders like government or corporations that SE, regardless of legal format, can deliver social impact.

The article has already identified numerous examples of support groups acknowledging SE in a manner that seemingly confirms its stature in the social sector. The most prominent support organization, Imagine Canada, references SE in a variety of contexts and also provides links to SE promoters.

The inclusion of a panel discussion on SE and the non-profit sector on the agenda of a government funded conference for NPOs also appears to affirm SE's presence in the social sector. It also demonstrated the concern that NCEs could be enabled with diverted social capital. Despite the topic's target audience clearly being NPOs, specifically those with public benefit missions, the panel had only one representative from the charity/NPO sector while the rest represented for-profit interests including the moderator. An impression that social good delivery has moved outside of its traditional territory could easily be taken away.

Hybrid Entities

Hybrid entities are emerging as the potential answer to the perception of a restrictive regulatory environment for charities and inequitable distribution of traditional business profit to private shareholders. According to one SE promoter "social entrepreneurs reject both the not-for-profit, charitable status and the traditional profit-maximizing approach of the for-profit

corporate structure". One SE resource describes them as "purpose-built corporate form for SEs". For some, a hybrid is the progression of traditional charity and consequently should be viewed with the same reverence.

The term hybrid is commonly used as the concept of charity and for-profit activity are seemingly fused together. They have been introduced in B.C. as Community Interest Corporations and in Nova Scotia as Community Contribution Companies.

The general view in the SE community seems to be a hybrid organization encapsulates the vision of 'business for good' which is affirmed by four characteristics:

- (1) They are for-profit entities, free of regulatory restriction on profit generation.
- (2) They are required to have a community benefit purpose (one that would not necessarily fall under one of the four heads of charity) and must submit an annual report on their community contribution to a regulator.
- (3) Their assets are 'locked' ensuring they do not end up in the hands of private interests.
- (4) Rather than private shareholders being the primary beneficiaries of company profit, dividends are capped to ensure the principal amount of its surplus revenues are reinvested into the organization.

Despite a hybrid organization's purposes not necessarily having public benefit they are viewed as being the vehicle in which social good can be achieved through for-profit activity while having the same level of accountability and asset protection as registered charities. It is advocated they should be considered a qualified donee, an option for government social funding, and perhaps be given receipting privileges. In other words, they should be eligible to receive social capital.

There does not seem to be an indication in SE resources of the practical application of a hybrid beyond a symbolic differentiation between it and traditional business. Similar to narrative found in the **Mobilizing Private Capital for Public Good** report, anecdotal evidence of self-described SE activity seems to be the primary basis for its emergence. Whether it is best suited to deliver a public benefit mission such as provision of essential goods and services; to reflect an organization's attempt to incorporate socially conscious business practices such as organically grown products or fair wages and trade*; or to confirm a retail business as an option for social consumerism, is not made clear.

** It is worth noting that a business that incorporates elements or practices that may be characterized as having a social, community or public benefit in a broader and non-legal sense likely would not meet the criteria for an NPO, a qualified donee, or an allowable registered charity activity.*

Hybrids as deliverers of public benefit

I see no reason to differentiate a hybrid from a traditional business when determining the optimum strategy for the provision of essential goods or increasing the employability of marginalized persons. With a for-profit motive and potential investors added to the mix, social capital would be at risk despite the allusion a hybrid is 'purpose-built' by its capture and reporting of community contribution.

It has been opined in legal circles that hybrid organizations, unlike charities, do not have any regulated mechanisms in place to steward social capital as an appropriate level of external accountability is not accomplished by the reporting requirement. Nor is there any kind of gauge in which to assess whether a hybrid's reported community contribution is acceptable or not. All that is required by the regulator for a hybrid to retain its status is an annual report; any indication of contribution appears to meet the criterion. In my view, this essentially eliminates any belief that a hybrid's asset lock would allow for the continued safeguard of charitable assets if they were gifted or directed as a PRI from a registered charity.

For the same reason, I would not suggest a hybrid that operates as a socially conscious business* should be viewed any differently; there is no guarantee that social impact, however it is defined, would be generated.

I question the practical application of a hybrid in general. In my opinion, a hybrid is at a strategic disadvantage compared to traditional business as it can only offer capped dividends to potential shareholders. By artificially limiting capital from functioning in its conventional manner, a hybrid may have trouble obtaining the necessary financing to launch or sustain its business. I would not recommend it as the strategic choice in a business/charity partnership, to operate a retail operation for 'social' consumers, or for a charity to incorporate a separate for-profit entity.

If a hybrid is intended to have a 'modest profit' approach rather than a 'profit-maximizing' one, this would also be strategically disadvantageous. In attempting to keep profits from being excessive, which on the surface sounds like it would require some unusual or not very business-like measures to accomplish, a hybrid could lose out on opportunities to generate significant revenues when they are presented to counter the inevitable times when business is slow. A 'modest profit' line of thinking is fundamentally not a way to run a sustainable business. If it is intended to represent the hybrid as a 'good' service which benefits participants or the community at large, then a charity option would be the practical choice if the intended benefits are charitable.

** Like other for-profit businesses, they would be best served by tax incentives, traditional financing, and economic development funding rather than use of social capital. Similar to a SEDA business (in an area of social and economic deprivation) discussed in Part 6 perhaps targeted supports could be developed if these businesses are formally recognized as being 'organic', 'local', or 'fair trade' according to established externally regulated criterion.*

Social Entrepreneurs

Another dynamic that should be considered when assessing the potential role of hybrids in the sphere of social good delivery are the motives of 'social' entrepreneurs.

The ability to make money while 'doing good' is mentioned often in SE narrative. Unlike traditional charitable work, there is no indication that opportunities for individuals to personally benefit from a SE activity would or should not be taken advantage of as long as social impact is being realized. And like traditional entrepreneurs, there is no reason to believe personal profit would have any hard stop as long as profits, both social and financial, are being generated. But the lack of any external regulatory scrutiny for hybrids means social outcomes are unguarded if personal financial goals conflict with social ones. The question asked in Part 9 arises again: People may be prepared to limit their financial motivations in order 'to good', but how far can one limit their motivation to 'do good' for financial gain and still have social impact?

In this case, one could potentially limit their motivation to 'do good' to whatever level they choose and still be financially rewarded. Even if a social entrepreneur is satisfied with a modest income, the reality and risk of operating in the marketplace likely puts them in a position of choosing between social impact or being able to continue operations.

This dynamic could lead to have another negative consequence. If hybrid organizations were financially successful, you can guarantee it would garner the attention of traditional entrepreneurs with no interest other than personal benefit. In theory, they could operate their business as a hybrid and take advantage of available social capital and/or social capital investment while contributing minimally to the community. The annual reporting requirement would neither discern limited impact or potentially, no impact at all. There does not appear to be any kind of measure to discourage financial-only motivations or those who would attempt to abuse this corporate form for private gain.

The reoccurring premise of SE's 'double bottom line' and its fallacy is prevalent here. Regardless of an entrepreneur's motivation, as long as a hybrid organization is financially viable it is presumably delivering social impact. Even if accountability measures were introduced to definitely and uniformly measure social impact, which undoubtedly would be very costly, how would one determine what level of social impact would be considered unsatisfactory? And similar to the challenges of Social Impact Bonds, if a minimum level was somehow established, how would one protect against an organization sacrificing inclusiveness in order to meet designated performance criterion?

While I do not question the good intentions of social entrepreneurs, the realities associated with operating a business likely means having to temper or park those intentions, especially public benefit ones, or choose another avenue in which to fulfill them such as a charity sponsorship or partnership. Similarly, a feeling that one's purposes should be held in a higher regard in comparison to traditional business does not diminish the need for practical consideration of appropriate legal structures and the regulations that accompany them.

Closing Comments

As the length of this article will attest, a discussion about SE and its application to the charity sector has many levels, some distinct, some nuanced. Trying to summarize it neatly is almost as challenging as writing the article itself. Hopefully an objective perspective on potential concerns has been impressed upon the reader and any sense of obstruction to social good has been alleviated by the manifestation of the article's secondary theme - the prospect of achieving the fundamental changes envisioned by the SE community within the current regulatory environment.

There are a number of concepts and intentions in which goods and services can be sold in and outside of the marketplace, with or without an element of social good. For practical reasons, the sale of a good or service by a registered charity does not automatically open the door to unrestricted revenue or present an opportunity for traditional investment capital, it is important registered charities become familiar with the specific circumstances in which revenue can be generated before committing resources to an initiative. The same can be said for sector organizations and agencies to ensure their efforts in support of charities are also strategically focused.

In a similar vein, I believe there is a need for SE promoters and other interested parties to better understand the legal environment for charities and, more importantly, its practicality in stewarding assets towards public benefit. This would lead to effective direction of resources for socially-minded intentions without introducing unnecessary financial risk and inefficient use of social capital.

The mechanisms of the marketplace and business also need lucidity. While there are no regulatory barriers preventing a 'social' entrepreneur from operating a for-profit entity with a public benefit goal, it is strategically less practical and stated intentions do not necessarily guarantee social impact. Likewise, traditional entrepreneurship and private shareholder distribution does not necessarily guarantee materialization of social issues.

The challenge in my mind is to find a thread that can connect the many different interests who seem to be part of the SE conversation. A leading authority on the legal environment relating to SE offers the opinion there likely is not one organization or individual that could bring all these different missions and mandates to the same conceptual understanding. To this sentiment I would add, as long as for-profit motive is given a primary role in the delivery of public benefit, a singular conceptual understanding, one that could be represented within a single organizational structure, likely cannot be established and with billions of dollars of social funding and donations potentially in play, should not be attempted. 'Social' and 'enterprise' can be partnered but it is best if it is done formally.

Similar to social entrepreneurs, while I do not question the aspirations of SE promoters and supporters, they need to be tempered in order to facilitate an impartial view of the for-profit/public benefit conflict dynamic. Through a lens free of cause-themed colouring, I believe there would be a better understanding of the potential concerns outlined in this article. I also believe there would be a raised consciousness of the opportunities already available to promote self-sufficiency and sustainability for marginalized persons and communities; to improve accessibility to essential goods and services; to enable 'social' consumerism and investment. With measured objectivity, interest in social issues and passion to 'do good' can be effectively directed to affect positive change.