

DO ONTARIO'S FOR-PROFIT SOCIAL ENTERPRISES FACE A CAPITAL GAP?

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2017

MaRS Centre for Impact Investing

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EXECUTIVE SUMMARY

A gap between the capital sought by social enterprises and the capital supplied by the market may dampen sector growth. To maximize jobs, revenue and social good, policy-makers must know if a capital gap exists and, if so, at what size.

We wrote this paper to help fill those blanks. We report the findings from a survey of 696 Ontario for-profit companies that claim a social purpose. In the survey, we asked respondents how much capital they sought in 2016 and how much capital they actually raised. From those numbers, we calculated a 2016 capital gap of \$45 M. We found that companies earning revenue were more likely to meet their capital targets than companies not earning revenue. We also found that companies with environmental goals were more likely to meet their targets than companies with social goals.

We acknowledge the limitations of self-reported capital demand. We therefore interviewed three entities that invest in Ontario's for-profit social enterprises. These investors validated the gap between demand and supply. All three saw room for more money in the market.

In sum, our data show that a segment of for-profit social enterprises believe that Ontario's social capital market offers too little investment to optimize growth. Capital to bridge that gap could yield better economic, social and environmental outcomes for Ontario.

INTRODUCTION

Social enterprises combine social goals and sustainable business models. They are designed to expand in revenue and employment as their social and environmental impact grows.¹ At scale, social enterprises contribute social solutions financed mostly or entirely by market revenue rather than by donations or government grants.

Yet some social enterprises struggle to scale. Some cannot raise enough money to survive the early days and expand to a size and sophistication that breaks even or turns a profit. That “capital gap”, the gap between capital demanded and capital supplied, may deprive Ontario of companies that could strengthen our social fabric and bolster our economy.

This report presents data on the capital gap facing Ontario's for-profit social enterprises. The data derive from a survey conducted in March 2017. The report supplements the survey data with numbers on Ontario's impact investment supply and perspectives from impact investors operating in Ontario.

This report uses Ontario's definition of a social enterprise: “An organization that uses business strategies to maximize its social or environmental impact.”² Ontario's definition does not discriminate between for-profits, nonprofits and charities. This report, however, will speak only to for-profit social enterprises. As explained in the methodology section, the survey's distribution strategy limited its reach to for-profit companies.

BACKGROUND

Other papers have reported on supply and demand in Ontario's for-profit social capital market. (This report, like the papers cited below, defines capital as both repayable funds like loans and non-repayable funds like grants.) The Social Finance Census 2010 collected responses from 138 Ontario social enterprises, 48 for-profits and 90 nonprofits.³ Of the for-profits, 79% reported access to capital as a barrier to social enterprise, 48% said too few intermediaries exist to direct capital to social enterprise, and 45% said too few investors understand dual-purpose businesses.⁴ 61% of the for-profits planned to raise money over the next two years.⁵

2015's Enterprising Change survey gathered responses from 108 for-profit social enterprises and 489 nonprofits in Ontario.⁶ Of the for-profits, 81% rated access to grant capital as a moderate or significant challenge. 77% said the same of loan capital.⁷

This report adds to the work already done by estimating a dollar figure for the difference between the capital desired by a segment of for-profit social enterprises and the capital supplied by the market.

1. In this report, “social” means “social and environmental.” / 2. Government of Ontario. (2015). *Impact: A Social Enterprise Strategy for Ontario*. Retrieved from <https://www.ontario.ca/page/impact-social-enterprise-strategy-ontario>
3. Malhotra, A., Laird, H., and Spence, A. (2010). *Social Finance Census 2010*. Retrieved from MaRS Discovery District: <https://www.marsdd.com/wp-content/uploads/2011/02/MaRSReport-social-finance-census.pdf> / 4. Ibid. / 5. Ibid.
6. Chamberlain, P., et al. (2015). *Enterprising Change: Report of the 2015 Social Enterprise Survey for Ontario*. Retrieved from CCEDNet: https://ccednet-rcdec.ca/sites/ccednet-rcdec.ca/files/2015-se-survey-ontario-report-enterprising_change.pdf / 7. Ibid.

METHODOLOGY

Ontario's eighteen Regional Innovation Centres (RICs) help companies grow. The RICs survey their companies every year. The data in this report draws from the March 2017 iteration of the RIC survey.

For-profits make up about 98% of RIC clients. For simplicity, we treated all of the survey respondents as for-profits.

The RICs distributed the survey by email on March 8, 2017. The companies received weekly email reminders to complete the survey. The survey closed on March 31, 2017.

In total, 5,160 companies received the survey and 1,446 responded. Of the 1,446 companies that responded, 696 claimed a social purpose and specified their social purpose from IRIS' list of social objectives (IRIS is a catalogue of social, environmental and financial metrics managed by the Global Impact Investing Network).⁸ Those 696 social enterprises are our sample.

The survey asked each company:

- a) if it raised capital in 2016
- b) how much capital it sought to raise, and
- c) how much it actually raised.

We excluded a company from our capital analysis if:

- a) the company said it did not seek to raise capital in 2016,
- b) the company said it raised money but did not enter an amount raised, or
- c) the company entered an amount raised but did not enter an amount it sought to raise.

Those exclusions left 343 companies that sought to raise money in 2016 and reported either an amount raised or failure to raise anything.

⁸. Respondents could select one or more of IRIS' social and environmental objectives. Social Impact Objectives. (June 9, 2017). Retrieved from <https://iris.thegiin.org/metric/4.0/OD6247>. Environmental Impact Objectives. (June 9, 2017). Retrieved from <https://iris.thegiin.org/metric/4.0/OD4108>. See Appendix A for key survey questions.

LIMITATIONS

Self-reported social purpose. The survey asked each respondent if it seeks a social purpose and, if so, the type of social purpose it seeks (as delineated by IRIS' list of objectives). We did not verify whether each respondent in fact seeks its professed purpose. Without verification, we cannot guarantee that an independent observer would see a social purpose in each company that claimed a social purpose. A little over half of the survey's respondents (757 out of 1,446) claimed a social purpose. (Sixty-one respondents claimed a social purpose but did not specify that purpose from IRIS' list of objectives.)

Sample bias toward early-stage technology companies. Only current and former RIC companies received the survey. RICs usually attract early-stage companies, the stage at which companies are most in need of advice, connections and capital. Established companies are less likely to seek a RIC's services. Our sample gave a median age of three years. The RICs also lean toward companies in high-technology sectors like healthcare and cleantech. Nearly half of our sample belongs to the advanced health, cleantech and information and communications technology sectors.

Self-reported capital plans. The survey asked respondents in March 2017 how much they had planned to raise in 2016. The survey therefore asked respondents to cast their minds back to the beginning of 2016 and to report their intentions of that moment. The actual results of the year may have coloured the respondents' estimates of past intentions. Of the 343 companies that intended to raise money in 2016, 107 raised exactly the amount they intended to raise.

SUMMARY STATISTICS

Number of social enterprises	696
Number with primarily social aims ⁹	530
Number with primarily environmental aims	124
Number with mixed aims	42
Number earning revenue	300
Number measuring impact ¹⁰	74
Number that did not seek capital	290

	25TH PERCENTILE	MEDIAN	75TH PERCENTILE
Years of age (n=552)	2	3	6
Full-time employees (n=571)	0	1	3
Part-time employees (n=569)	0	1	2
Capital sought (n=343)	\$42,500	\$150,000	\$500,000
Capital raised (n=343)	\$0	\$50,000	\$315,000

SOURCES OF CAPITAL ¹¹	NUMBER SOURCED	MEDIAN RAISED
Angel investors	59	\$300,000
Venture capital	26	\$400,000
Other private capital	108	\$50,500
Provincial government	105	\$30,000
Federal government	105	\$60,000
Other	47	\$57,500

⁹ If a company selected more social objectives than environmental objectives, we categorized it as primarily social. If a company selected more environmental objectives than social objectives, we categorized it as primarily environmental. If a company selected the same number of social objectives and environmental objectives, we categorized it as mixed. See Appendix A for key survey questions. / ¹⁰ The survey asked respondents to indicate how they measured their impact. Respondents could select from the Global Impact Investing Ratings System, B Corp, Social Return On Investment, Theory of Change or custom metrics. The table indicates the number of respondents that selected one or more of the measurement options. See Appendix A for key survey questions. / ¹¹ This chart only covers the 343 companies in the capital analysis sample.

RESULTS

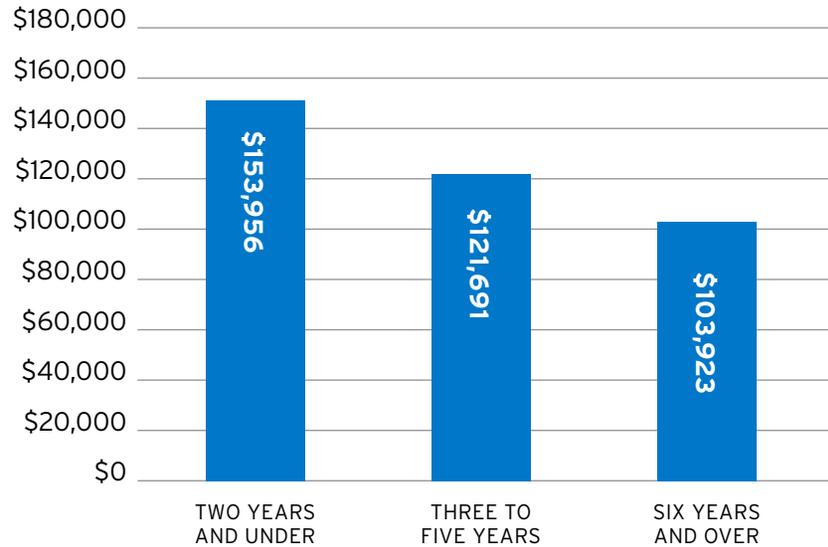
Our data suggest a 2016 capital gap of about \$45 M. To reach that number, we first subtracted the amount of money that each respondent raised from the amount the respondent sought to raise. That operation returned a capital gap for each company (companies that raised more than they sought returned a negative capital gap). We then excluded capital gaps more than three standard deviations from the mean. Without that step, outliers—companies that sought much more than they raised and companies that raised much more than they sought—would dominate the calculation.¹² Finally, we added all capital gaps within three standard deviations to arrive at \$45 M.

We emphasize that that number is not and cannot be converted into a capital gap for all of Ontario's for-profit social enterprises or even for the province's early-stage, technology-focused social enterprises. Our data only permits us to estimate the capital gap for our respondents.

On the following page we've broken the data along four variables.

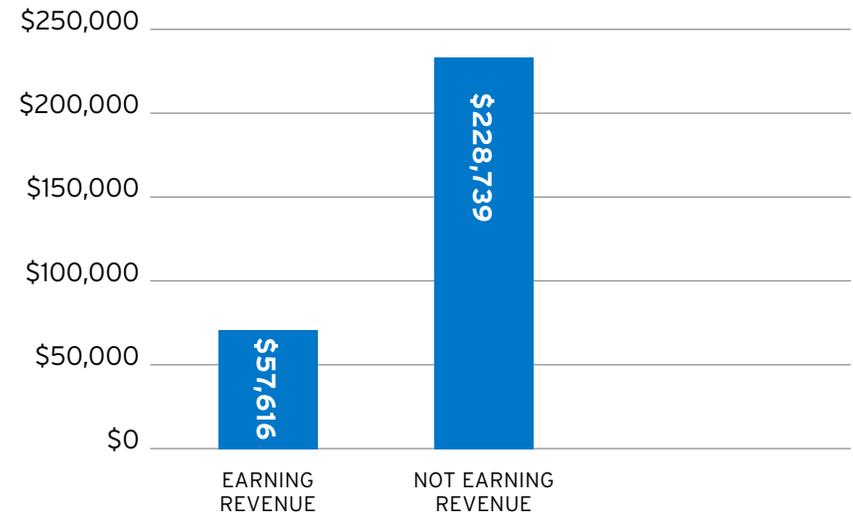
¹². Without removing the seven companies that fell outside three standard deviations, the capital gap would equal \$98 M.

Graph No. 1: Average Capital Gap by Age of Social Enterprise



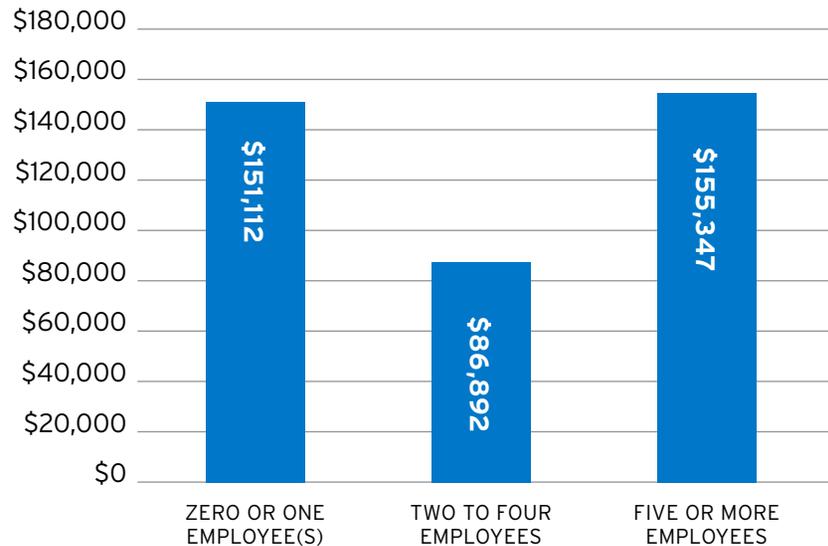
Two years and under: n=113. Three to five years: n=98. Six years and over: n=79.

Graph No. 3: Average Capital Gap by Revenue Stage



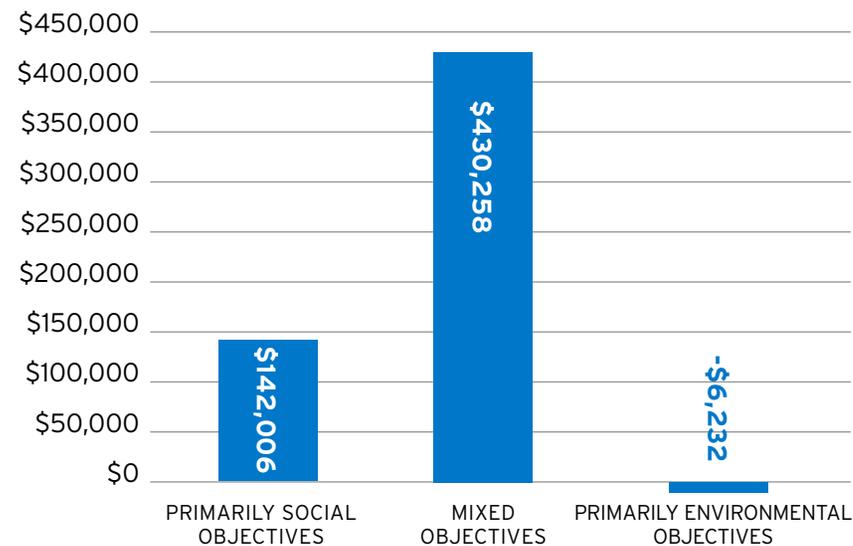
Earning revenue: n=153. Not earning revenue: n=158.

Graph No. 2: Average Capital Gap by Total Number of Employees (Both Full-Time and Part-Time)



Zero or one employee(s): n=86. Two to four employees: n=93. Five or more employees: n=118.

Graph No. 4: Average Capital Gap by Objectives



Primarily social objectives: n=255. Mixed objectives: n=21. Primarily environmental objectives: n=60.

RESULTS CONTINUED

Two interesting points rise from the graphs. First, the average company without revenue fell further short of its capital target than the average company with revenue. To take the numbers a different way, 54% of companies without revenue missed their capital targets compared to 43% of companies with revenue. The data lends support to the idea that it is difficult to raise money before you are earning money.

Second, the average company focused on environmental objectives raised slightly more than it aimed to raise, while the average company focused on social objectives raised less than it aimed to raise. Of the social companies, 19% exceeded their capital targets and 48% fell short. Of the environmental companies, 27% exceeded their targets and 43% fell short. (Note that the average environmental company exceeded its target because a few of the environmental companies exceeded their targets by huge margins.) The data bolsters the notion that investors see greater financial promise in cleantech and similar fields than they do in many social sectors.

INVESTOR IMPRESSIONS

We interviewed three impact investment funds that invest in Ontario for-profit social enterprises. In doing so, we sought to check our capital gap data against the perspectives of those on the other side of the equation. We asked if the investors see more high-quality social enterprises than they have the money in which to invest or if, instead, the investors struggle to find enough high-quality social enterprises to fill their funds.

Combined, the investors review about 140 companies per year at some depth. (We define some depth as at least a couple of meetings between the investor and the company.) The investors have deployed \$15 M to date and intend to deploy about another \$15 M.

All three of the investors saw room for more investment in Ontario's social enterprises, but differed somewhat on the stage at which enterprises need more capital. Two investors pointed to a gap for early-stage companies. The third investor did not see a gap in early capital—it believes that impact investors already fill the demand for early-stage social finance—but saw a gap in growth capital. Social enterprises that pass the seed stage cannot always find mission-aligned money at growth-capital sizes.

The investors' perspectives help to validate the survey's gap between capital sought and capital raised. Surveys that rely on companies to assert how much capital they deserve will come under scrutiny. Entrepreneurs skew toward optimism and some may seek more capital than would actually support their growth. Our conversations with investors suggest that those on the other side of the table see room for more money and more players in their market.

IMPACT INVESTMENT FUNDS IN ONTARIO

We intended to review Ontario's social capital supply and analyze how well that supply matched demand. The capital strategies of social enterprises, however, belie such an approach. Social enterprises pull money from many sources, most of which serve ordinary business just the same as they finance social enterprise. Citing the amount that each of these sources—provincial programs, federal programs, banks, credit unions and others—invest would not illuminate the capital gap facing Ontario's mission-oriented companies.

Instead, on the following page, we've listed impact investment funds that invest in Ontario social enterprises. We do not suggest that the capital gap must be filled by these or similar sources. Rather, the chart simply gives a sense of some of the impact-tied money available to invest in Ontario.

FUND	HEADQUARTERS	INVESTMENT REGIONS	APPROXIMATE SIZE	FOCUS
Cycle Capital Management Funds I, C3E and III	Montreal	Canada and United States	\$231 M ¹³	Cleantech venture capital ¹⁴
Renewal2 and Renewal3 Investment Funds	Vancouver	Canada and United States	>\$100 M ¹⁵	Cleantech venture capital ¹⁶
The Atmospheric Fund	Toronto	Greater Toronto and Hamilton Area	>\$50 M ¹⁷	Mix of financial tools. Invests mostly in buildings and companies ¹⁸
InvestEco Sustainable Food Fund	Toronto	Canada and United States	\$26 to \$50 M (US) ¹⁹	Food and agriculture venture capital ²⁰
ArcTern Ventures	Toronto	Canada and United States	\$30 M ²¹	Cleantech venture capital ²²
CoPower	Montreal	Canada and United States	\$12 M ²³	Cleantech project finance ²⁴
New Market Funds Rental Housing Fund	Vancouver	Canada	\$11 to \$30 M ²⁵	Affordable housing finance ²⁶
RBC Generator	Toronto	Canada	\$10 M ²⁷	Impact funds, companies and projects ²⁸
Community Forward Fund	Ottawa	Canada	\$9.8 to \$20 M ²⁹	Nonprofit loans ³⁰
MaRS Catalyst Fund	Toronto	Canada	\$5 M (expected)	Cleantech, healthcare and education / employment venture capital
VERGE Social Enterprise Loan Fund	London	Southwestern Ontario	\$232,000 ³¹	Social enterprises in Southwestern Ontario ³²

13. Cycle Capital Fund I, L.P. (\$80 M): Cycle Capital Management. (2009). Cycle Capital Management Conducts First Closing of Cycle Capital Fund I, L.P. [Press Release]. Retrieved from <http://www.cyclecapital.com/cycle-capital-management-conducts-first-closing-of-cycle-capital-fund-i-l-p/>. Seed Fund Cycle-C3E. (\$42 M): Cycle Capital Management. (2011). \$42M in Venture Capital to be Invested in Québec Companies Specializing in Clean Technologies [Press Release]. Retrieved from <http://www.cyclecapital.com/42m-in-venture-capital-to-be-invested-in-quebec-companies-specializing-in-clean-technologies/> Cycle Capital Fund III L.P. (\$108 M): Cycle Capital Management. (2013). Cycle Capital Management Capitalizes More Than \$100 Million for its Investment Platform's Third Fund [Press Release]. Retrieved from <http://www.cyclecapital.com/cycle-capital-management-capitalizes-more-than-100-million-for-its-investment-platforms-third-fund/>

14. Cycle Capital Management. (2017). Federal Budget: Cycle Capital Welcomes the Government of Canada's Decision to Accelerate Investments in Clean Technologies [Press Release]. Retrieved from <http://www.cyclecapital.com/federal-budget-cycle-capital-welcomes-government-canadas-decision-accelerate-investments-clean-technologies/>

15. Visscher, J. (January 11, 2017). Canadian investor profiles. Corporate Knights. Retrieved from www.corporateknights.com/channels/responsible-investing/canadian-investor-profiles-14841144/

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17. Ehlich, T. (May 30, 2017). New study shows high potential for EV Uptake in Toronto region, but few drivers know about purchase incentives [Press Release]. Retrieved from <http://taf.ca/media-release-ev-survey/>

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22. ArcTern Ventures. (June 12, 2017). Retrieved from <http://www.arcternventures.com/#opportunity/>

23. CoPower. (2017). CoPower, Canada's leading clean energy fintech company, raises \$2 million in equity financing from strategic investors [Press Release]. Retrieved from https://copower.me/files/1015/0150/1325/CoPower_closes_2M_equity_round.pdf

24. Project Financing. (June 12, 2017). Retrieved from <https://copower.me/en/financing/>

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26. New Market Funds. (June 12, 2017). Retrieved from <http://newmarketfunds.ca/>

27. Investing for Impact. (June 12, 2017). Retrieved from <http://www.rbc.com/community-sustainability/rbc-social-finance-initiative/investing-for-impact.html>

28. Ibid. / 29. New Market Funds. (2014). Eight Tracks: Impact Investing in Canadian Communities. Retrieved from <http://newmarketfunds.ca/pdf/Eight-Tracks.pdf>

30. Ibid. / 31. VERGE Portfolio. (August 8, 2017). Retrieved from <http://www.vergecapital.ca/portfolio>

32. VERGE Social Enterprises. (August 8, 2017). Retrieved from <http://www.vergecapital.ca/social-enterprises>

CONCLUSION

Our survey of nearly 700 for-profit social enterprises revealed a capital gap of approximately \$45 M. Many different kinds of investors, from governments to venture capitalists to project lenders, serve Ontario's for-profit social enterprises. Yet many enterprises still cannot raise as much money as they believe they need to survive and grow.

The capital gap, reported at least since 2010 and repeated here, has persisted even as interest in social finance has risen and the class of impact investors has expanded. Social enterprises are not slowing down. Bold new money, whether public, private or somewhere in between, may move more of Ontario's social enterprises to scale.

APPENDIX A: KEY SURVEY QUESTIONS

CAPITAL GAP

1) Did your venture raise any funds (debt, equity, grants) in 2016 (Jan. 1, 2016 to Dec. 31, 2016)? This includes both non-Canadian and Canadian funding sources.

- a) Yes
- b) No, and was seeking to raise funds
- c) No, but was not seeking to raise funds

Amount of funding you were seeking to raise in calendar year 2016:

FUNDING SOURCE	AMOUNT	SOURCE(S)	EXAMPLES OF SOURCES
Federal government			VentureStart, FedDev Ontario Applied Research and Commercialization Initiative, FedDev Ontario Investing in Business Innovation, FedNor, Industrial Research Assistance Program, Natural Sciences and Engineering Research Council of Canada, Mitacs, SmartStart Seed Fund, Canadian Innovation Commercialization Program, Scientific Research and Experimental Development Tax Incentive Program, Southern Ontario Fund for Investment in Innovation, Innovation Initiatives Ontario Grants (Step Forward Entrepreneurs Program, Innovative Manufacturing and Facilitation Program, Youth Entrepreneurship Placement Program)
Provincial government			Business Acceleration Program (Embedded Executive, Embark), Ontario Centres of Excellence (Market Readiness or other), Regional Innovation Centres Regional Advisory Funding (\$5,000), MaRS IAF
Private - venture capital			
Private - angel			
Private - other			Friends and family, commercial grants and funding
Other (not private)			Business Development Bank of Canada, Canadian Youth Business Foundation, banks, mortgages, sources outside of Canada

APPENDIX A: KEY SURVEY QUESTIONS

SOCIAL IMPACT

1) Individuals can have non-financial motives for launching new companies. Was your business founded to address social or environmental impact as part of its core mission and vision?

- Yes No

2) Which of the following social or environmental impact objectives is your venture addressing? (Check all that apply.)

Social Impact Objectives

- Access to clean water
- Access to education
- Access to energy
- Access to financial services
- Access to information
- Affordable housing
- Agricultural productivity
- Capacity building
- Community development
- Conflict resolution
- Disease-specific prevention and mitigation
- Employment generation
- Equality and empowerment
- Food security
- Generate funds for charitable giving
- Health improvement
- Human rights protection or expansion
- Income/productivity growth

Environmental Impact Objectives

- Biodiversity conservation
- Energy and fuel efficiency
- Natural resources conservation
- Pollution prevention and waste management
- Sustainable energy
- Sustainable land use
- Water resources management

3) Does your venture define or track its social / environmental impact using any of the following measurement approaches? (Check all that apply.)

- Global Impact Investing Ratings System (GIIRS)
- B Corp
- Social Return On Investment
- Theory of Change
- Custom metrics (please explain)
- Other (please explain)
- Not yet, exploring how to do this
- No, not interested

ABOUT MARS

MaRS Discovery District is a not-for-profit innovation hub dedicated to driving economic and social prosperity by harnessing the full potential of innovation. MaRS works with entrepreneurs and investors to launch and grow companies that have broad economic and societal impact, and convenes governments and industry stakeholders to enable widespread adoption in complex markets and systems.

Questions or comments?

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