

SOCIAL ENTERPRISE IS A NICE IDEA, BUT IT IS NOT A PANACEA THAT JUSTIFIES REWRITING CHARITY LAW

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POINT : BOB WYATT

You can't read a newsletter or go to a sector conference these days without being batted heavily about the head by the concept of social enterprise. It is, according to proponents, the greatest thing since sliced bread or the remote control; it's going to solve all of the sector's problems and allow organizations to grow and be more sustainable and better able to serve Canadians. All we need to do is totally rewrite charity law in Canada and billions of dollars will suddenly appear to support all these social enterprises.

Sorry. I'm not buying. Not yet at least.

My first problem is that I haven't found a commonly accepted definition of what social enterprise is. To some, it's any business activity operated by a charity. To others, it seems to mean anything run by any type of organization (private or charitable) so long as some portion of the money ends up going to a charity.

"Trading activities," as they're called in some places, aren't exactly new. Girl Guides have been selling cookies for an awfully long time. Ys have been selling memberships to their fitness facilities. Thrift shops have been around for quite a long time, too.

And it's true that I've seen some interesting examples: the courier service in Toronto that uses developmentally delayed adults as the couriers; the restaurant in Edmonton's City Hall that teaches street youth and prepares them for jobs in the hospitality industry; the magazines sold by homeless people on street corners. Theatres and art galleries have been engaging in business-like activity for years. Universities have become increasingly (perhaps even disturbingly) more active as they patent everything their researchers have even thought about.

But what doesn't seem to be getting through to proponents is this: Most of these are charitable activities already. We don't need any legislative changes to allow them.

So, we're apparently talking about something different than the examples mentioned above. But just what we're talking about still escapes me. At one conference, I'm hearing about charities that want to sell equity interests or that simply want to get access to loans so they can grow to scale. At another conference, I'm hearing about establishing private-sector organizations that will be treated like charities because they give some (unspecified) amount of profits to charity.

Indeed, at one conference last year, the closing debate underlined my problems with all of the “selling” of social enterprise that’s now going on. One delegate stood up and said that if the movement (yup – they’re now considering themselves a full-fledged movement) was going to get the (unspecified) regulatory changes they want, they should agree on a common definition. Another delegate immediately stood up and said they had been debating a definition for 10 years and got nowhere, so it was time to move on.

There were a couple of things that concerned me at these conferences. The first was the ignorance of the existing rules and what is already allowed and what isn’t. Much of what was being presented would already fall within acceptable charitable activities, provided the charity’s purposes were broad enough to allow them.

More concerning was the naiveté that I heard. Some people were arguing that these social enterprises should get charity-like treatment, no matter how they were established – as charities, nonprofits, or even profit-making entities. But these same people were also saying that nobody was going to have to ensure the ongoing public benefit of these organizations – there would be no regulatory oversight. And the people promoting the sale of equity positions in social enterprises actually seemed to believe that provincial securities regulators weren’t going to have any authority over them.

I don’t know where these people got their rose-coloured glasses, but they have an entirely different understanding of how the world operates than I do. If the federal government is going to provide some form of tax break to these social enterprises (however you define them), then the government (not unreasonably) is going to want to know exactly who qualifies and how one ensures that they continue to qualify. That means establishing some form of definition or boundary – one that differentiates a social enterprise from a business that makes charitable donations. And if people actually believe that securities commissions aren’t going to want to have some rules around who can sell investments, all I can do is shake my head.

The Australian Centre for Philanthropy and Nonprofit Studies at the Queensland University of Technology (QUT) in Brisbane is doing some interesting research on social enterprise in that country. They’ve come up with a three-fold definition. To be considered a social enterprise, an entity a) must be established for the community or public benefit; b) trades to fulfil its mission; and c) reinvests a significant portion of its earnings in its mission.

I think I could probably live with that sort of definition. But as far as I can tell, such an entity, if operated by a charity, is already allowed, provided its purposes are broad enough. I can’t see that we would require legislative change to allow this. It may be that some CRA policies need to be rewritten, but not in any major way. And I don’t see that we need to create some sort of new type of corporate entity to allow it.

Associate Professor Jo Barraket, who leads the social enterprise research team at QUT, pointed out another thing. Since governments (and some other funders) started using competitive tendering for the award of contracts and grants, every one of the organizations that submits a tender is, by definition, a social enterprise.

And she told me something else that I hadn't thought about. In Australia, one of the reasons that social enterprises are springing up in some rural and remote areas is to fill service gaps caused when private-sector entities close up shop. A group of people from the community band together and decide the community can't live without the petrol station, or the hospital, or even the pub. So they create an entity that the community owns and operates.

There are a few things that I think we have to remember during our on-going discussions of this social-enterprise concept:

First, I suspect there are precious few organizations that are capable of engaging in social enterprise in any significant way. Even some of the largest organizations won't have the interest or capacity to engage in this type of activity to any great extent. So how many organizations are going to be "saved?"

Second, I have seen absolutely no evidence to support the theory (hope) of some proponents that a broader social-enterprise movement will result in huge amounts of capital suddenly being available to them. Foundations can already lend money to charities, but few do. Banks can lend money to charities, but don't, at least not without personal guarantees – but that's no different than the way they treat small businesses. I just don't believe that there's this huge pool of capital sitting around, doing nothing, just waiting for social enterprises to flourish.

Third, I haven't seen any data that indicates the Community Interest Corporations in England or the L3C entities in some U.S. states have resulted in new money or support; in fact, most of the money continues to come from government.

Fourth, we have no data to indicate that social enterprises are any more robust or sustainable than small businesses. If we have the same failure rate as small businesses, how is that going to affect public confidence in charities?

Fifth, the type of change that some are requesting is certain to raise the usual noise from business organizations, complaining about unfair competition by charities or organizations that get some sort of special tax treatment. Most of those arguments are bogus, but that doesn't mean that politicians don't listen.

Finally, there may be very valid reasons for establishing trading activities outside of the charity. That limits the liability of the charity. And even if these new entities have to pay taxes, it's not going to have that much impact. The Muttart Foundation recently had some research done by a major accounting firm, looking at the impact of taxes on a charity-owned entity if it makes the maximum charitable donation and then pays up the rest by way of dividend to the charity. At \$1 million earnings, the effective tax rate is about 3%. I'm not sure that's worth a public-policy fight.

Associate Professor Barraket hypothesizes that some of the drive for a new form of corporate structure or regulatory change is a fundamental disagreement by the new generation of entrepreneurs with the regulation of charities. They don't want that much oversight or transparency. I can understand that. But my answer is, "Then don't become

a charity. Be a private-sector company, pay your taxes, and send the rest to a charity of your choice.”

I'm all in favour of charities becoming more sustainable. But I'm not convinced that what we're being bombarded with now lives up to its billing as being the way to save the sector.

COUNTERPOINT : DON BOURGEOIS

It is very disturbing to me, Bob, when you and I are in agreement. It reminds me of a scene in the original *Ghostbusters*; but no need to date myself too much. Perhaps, as you suggest, the issues around social enterprise are in part generational.

Social enterprise is something that many charities have undertaken for years. We have given it different names. Indeed, many grants in recent years have been dependent in part on the level of “earned revenue” a charity has. Some government programs have pushed charities into the earned revenue stream in order to reduce overall grant allocations or to reallocate those grants to organizations that are more successful, i.e., that can demonstrate a greater level of community support as measured by the size of the earned revenue. Some business leaders have also referred to the level of earned revenue as a factor in their decision about whether or not to enter into a sponsorship.

Charities need money. That fact is undeniable.

The source of the money and what society deems to be appropriate sources evolve or change with the times. At one time, governments were a minimal contributor to many charities. Organizations relied upon private philanthropy and, in reality, “earned revenue” to support their charitable activities. Then governments became a significant source for organizations, in particular in social services, health care, and education. More recently governments started to resile from expenditures in order to cut taxes or in reaction to public perceptions – notwithstanding that the public perception of the level of government funding for, say, arts organizations, is probably substantially higher than it really is.

The discussion about social enterprise is, nonetheless, worthwhile. But it has been unfocused and too scattered. Some of the problems with the discussion have been lack of knowledge and of a concerted and considered effort to determine what the sector and the community need and want. Absent at these discussions too often have been informed analysis, including work from the Muttart Foundation, Tides Canada, and others.

We need a mature and sophisticated discussion about social enterprise, however it is defined. That discussion needs to keep in mind that charities are fundamentally not businesses – they do not exist to make and distribute profits. They exist to carry out charitable activities. They exist to provide public benefits as changing contexts create new circumstances and perspectives. And this, Bob, is where you and I start to diverge, if we have not already in our analysis and conclusions.

Why do we need a change in the law of charity? Interestingly, in my view, largely because the institutions, courts, governments, and proponents have so screwed up the discussion

that we need a context-changer. The recent repeal of Ontario's Charitable Gifts Act has started to change the law of charity as it applies to social enterprise concepts. The repeal removed a statutory restriction on a charity owning a business which, in Ontario, was a significant impediment to developments of social enterprise.

There are a few parts of the context in which this discussion is occurring that need to change:

1) The courts have failed to keep "charity" modern and in accord with the times. We should always expect the courts to lag behind the times because that is just reality and what is needed. There are too many flavours of the day that will not withstand close examination. Being a few years behind the times allows many of the weakest to die off before too much is invested. But the courts have decided not to advance the law of charity, deferring instead in a couple of key cases to Parliament.

2) Parliament has failed – and by Parliament, I include both the federal Parliament and the provincial legislatures. Charities represent a substantial part of Canada's economy, even without hospitals and universities, yet how often do Ministers of the Crown address the sector in any serious and concerted way? Just check the list of topics for the Budget Speech for 2010 to see how important charities are.

3) Canada Revenue Agency (CRA) has failed to advance through policy or otherwise an approach that will modernize the understanding of "earned revenue" and what a charity may or may not do. While I fully understand the need to protect the "tax base," CRA seems to be very timid. There needs to be a significant change in its approach – but having said that, there appears to be some sympathy at CRA that changes are needed.

4) The sector needs a reality check – we live in a highly regulated society; recognize it and get with it. I have encountered too many in the sector who believe that charities ought not to be regulated because they "do good." While charities are intended to "do good," having been a regulator for many years, it is readily apparent that not all charities "do good" and in some cases are not really trying to do so.

Some charities want to "do good" but do not understand, and at are times are not aware of, the legal context in which charities operate. I am familiar with an organization that does good by making energy efficient, low polluting cars available to its members thereby reducing the carbon footprint. The problem is, to raise money to purchase the vehicles, the organization is selling shares – and doing so without any regard to securities legislation, which is there to protect the public.

The sector needs to recognize and accept that a regulatory environment creates the balance that is necessary in society. And regulation is not new; it has been around for many centuries. After all, the Statute of Elizabeth I,

the source of much of charity law, was regulatory in nature. What we need is to understand the regulatory structure that exists and make adjustments both to it and to how charities “do business” in “doing good.” In the case of the car charity, the legal context likely needs to be changed for the charity to be able to do good. What is the proper balance in information to be provided to and relied upon by the “investor” where the “investment” is largely to provide a private benefit to the shareholder but also a public benefit in reduced pollution?

5) Politicians need to do what is needed to be done – politicians like to be seen to be making change because change means that politicians are effective. If we can engage the political leadership to change the laws, (even when some would argue that the change is not critical to success) we will have engaged a politician to change the context in which charities operate. Perhaps this argument is circular, but so be it. It matters because once engaged and the politician sees “success” from his or her perspective, he or she will be more willing to take further action – and at times, action that some may consider riskier.

The change in law need not be huge. Perhaps what is needed is something that redirects the path on which we are now treading, which seems at best to be headed in a circle and at worst nowhere. But we also need to define better what our objectives for social enterprise will be. For example, can we expand CRA’s perception of what an “umbrella charity” may do and for whom it may do it? We need to recognize that efficiency and effectiveness in the charitable world sometimes requires the participation of the private sector to make a program work. What is the proper balance of for profit and nonprofit? What are the criteria to be used in determining that balance? While a chain of gas stations across Canada may not be charitable in anyone’s mind (okay, a few but we will not pursue that line), certainly a gas station in an area vacated by business suggests a “public benefit” opportunity exists. What are the criteria to decide what is or is not a “public benefit?”

So, while Bob is correct about a number of key factors, I think we do need new law. We need it not so much because the law of charity is not flexible enough in theory but because we have successfully made it inflexible in reality. The courts will not consider substantive change, CRA cannot or will not advance it, and the sector does not seem capable on its own to do so.