Social Enterprise and Social Finance: A Path to Growth

Proposal

This paper responds to the report of the Strategic Group on Social Enterprise and Social Finance (the Strategic Group) which has outlined a strategy for growing social enterprises and social finance in New Zealand. Initial Government actions are proposed, to be coordinated by a cross-agency working group.

Executive summary

Social enterprises are hybrid organisations mixing social goals with a commercial orientation. Social enterprises have the potential to contribute significantly to economic growth, particularly in disadvantaged regions, and to address social and environmental issues. Social enterprise is capturing the imagination of a new generation of entrepreneurs and investors who want to combine business with social good.

A Strategic Group of mostly non-government experts, convened at my request, has reported on barriers to social enterprise and social finance. This Cabinet paper responds to the Group’s recommendations. Initial government action areas include building knowledge of social enterprises, a coordinated approach to funding support services, actions to encourage investment, and promotion of the Social Enterprise World Forum (SEWF) 2017 in Christchurch.

I propose this work be coordinated by a cross-agency working group, initially led by the Department of Internal Affairs (DIA), with the Ministry of Business, Innovation and Employment (MBIE), Te Puni Kōkiri (TPK), and the Social Investment Unit (SIU) as core members, joining up work across government. This group will further refine the work programme, and consider resourcing needs, including for collation of baseline social enterprise data.

I recommend the Regional Economic Development (RED) Ministers’ Group and associated Senior Regional Officials’ Group monitor this work, including consideration of a detailed work plan and confirmation of the future lead agency, by April 2017.

Background

Social enterprises trade to generate finance for a social or environmental mission. Some are companies that provide returns to investors, while also directing profit into achieving their social mission. Others are non-profit organisations, often generating income through separate trading arms. Further information on the nature of social enterprise is provided in Appendix A.

In 2013, Cabinet agreed to adopt a Government Position Statement on Social Enterprise (Appendix B) [SOC Min (13) 27/4]. In 2015, I reported on cross-agency progress in supporting social enterprise. Cabinet directed DIA to work with experts on strategic actions to enhance social enterprise development and social impact investment and report to me.
8. Cabinet also:
   • noted that, following Vote Internal Affairs funding for social enterprise development services from 2013/14 to 2015/16, I would consider options for funding capability-building in out-years;
   • noted that Philanthropy New Zealand was developing a social impact investment fund, and would seek government co-investment; and
   • agreed to endorse a Christchurch-based bid to host the SEWF in September 2017, provided no Budget bid is required [SOC Min(15)11/3].

9. On 25 October 2016, I reported to Cabinet on my trip to the SEWF 2016 in Hong Kong, where responsibility for hosting the 2017 event was formally handed to New Zealand.

The opportunity to grow social enterprise and social finance

10. On 11 October 2016, I hosted the release at Parliament of Social Enterprise and Social Finance: A Path to Growth (available at www.dia.govt/cvs), a report written by an expert Strategic Group, at my request. I endorse the Group’s vision of ‘flourishing social enterprises and a dynamic social finance market’, involving a pipeline of capable social enterprises, and a finance pathway suitable for each stage of social enterprise development (Appendix C). Strategic Group members are listed in Appendix D.

11. Social enterprise potential is illustrated in Scotland, which has a similar population size to New Zealand. It has more than 5000 social enterprises, employing more than 112,000 people and contributing £1.68 billion to the Scottish economy.

12. Social enterprise has strong potential in regions of higher deprivation where social issues are likely to drive economic activity. Areas with high Māori populations are also likely to benefit, as the model aligns well with a whānau-focused approach to business. A robust market of capable social enterprises can support Business Growth Agenda and Social Investment goals, for instance, by:
   • harnessing entrepreneurship to innovatively tackle persistent social and environmental issues;
   • growing businesses in areas of labour market disadvantage, including employment and training for people otherwise not work-ready or overlooked by other businesses; and
   • helping community organisations achieve greater financial sustainability through commercially rigourous trading practices.

13. Social enterprise can attract investors seeking “social impact investments”, where positive social outcomes are generated alongside financial returns. This is a step further than traditional approaches to corporate social responsibility and ethical investments. Internationally, private sector investors are showing increasing interest in this. A 2016 JP Morgan survey of 158 investors found USD77.4 billion of social impact investments being managed, up from USD60 billion in their 2015 survey of 146 investors.

14. Philanthropists have the opportunity to extend their support from charities to social enterprises. Considerable new finance could open up if philanthropic trusts were to expand their activities beyond grant-making, and utilise their investment portfolios for social loans.
The challenges

15. However, there are barriers to growth of this newly emerging sector. Figure 1 summarises the Strategic Group’s view of the main issues. In particular, I agree that social enterprises need assistance to increase their business capability. Skill gaps reduce ability to grow and attract investment. I also agree that overarching data is needed on the size and contribution of social enterprises, to provide a base for policy decisions. Information is also lacking on accessibility of mainstream support services, and the benefits of specialised social enterprise development services.

Figure 1: Strategic Group view of barriers to social enterprise

<table>
<thead>
<tr>
<th>BARRIERS TO SOCIAL ENTERPRISE AND SOCIAL FINANCE</th>
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<tbody>
<tr>
<td><strong>Sector data and profile</strong></td>
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<tr>
<td>A fragmented social enterprise sector, not well understood</td>
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<tr>
<td>Lack of data on social enterprises and their performance</td>
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<td>Limited information on impact measurement models</td>
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<tr>
<td><strong>Social enterprise development</strong></td>
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<tr>
<td>Significant business development needs</td>
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<td>Weak regional economic development links</td>
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<tr>
<td>Limited education and capability development for youth</td>
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<tr>
<td>Māori, Pacific and ethnic social enterprise potential under-developed</td>
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<tr>
<td><strong>Barriers for funders/investors</strong></td>
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<tr>
<td>Barriers for charities wishing to fund profit-distributing social enterprises</td>
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<tr>
<td>Compliance costs for loan-makers</td>
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<tr>
<td>Lack of specialised financial intermediaries</td>
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<tr>
<td>Uncertainty about social enterprises models</td>
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<tr>
<td>No investment mechanisms for investors</td>
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<tr>
<td><strong>Finance for social enterprises</strong></td>
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<tr>
<td>Difficulty accessing development grants</td>
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<tr>
<td>Constraints in competing for contracts</td>
</tr>
<tr>
<td>Difficulty accessing loans</td>
</tr>
<tr>
<td>Equity offers inaccessible or unsuitable</td>
</tr>
<tr>
<td>Debt securities compliance costs</td>
</tr>
</tbody>
</table>

16. Issues for funders include that philanthropic trusts lack understanding of, or are daunted by, regulatory requirements associated with becoming social lenders. Investor uncertainty about the social enterprise model and limited availability of specialised advice, may also be inhibiting the market. However, social enterprises are starting to have successes with newly available equity crowd-funding, and peer-to-peer lending has potential to increase. The Financial Markets Conduct Act 2013 allows some useful exclusions from regulatory requirements for debt securities, including for offers under $2 million with fewer than 20 investors.

Areas for action

17. Appendix E outlines the Strategic Group’s recommendations targeted at Government, and government agency responses. Social enterprises are inherently innovative organisations aiming to be self-sustaining. There are Strategic Group proposals that are not aimed at Government, such as potential development of a national social enterprise member-based organisation. However, as with mainstream business, there is a role for Government to help stimulate the sector’s development, which will in turn support Government economic and social objectives.

Cross-agency actions and collaboration

18. Social enterprise activity touches on many portfolios, but government agency responses to-date are uncoordinated. The Strategic Group proposed a Social Enterprise Unit be located in MBIE, to build links to key government priorities, tackle data gaps, review social finance barriers, and overview capability-building and funding programmes.
19. Rather than expensive structural solutions, I favour a cross-agency working group. For continuity, this would initially be led by DIA, with MBIE, TPK, and SIU as core members.

20. Other agencies which may be included in the cross-agency group as required are Statistics New Zealand (Stats NZ), the Ministry of Social Development (MSD) including the Ministry of Youth Development (MYD), the Ministry of Foreign Affairs and Trade (MFAT), Financial Markets Authority (FMA), Ministry of Justice (MoJ), and Inland Revenue.

21. Links will also be forged to the Māori Economic Development Virtual Policy Unit, which comprises the Treasury, TPK, MBIE and the Ministry of Primary Industries. This Unit has identified social enterprise as a priority, and will monitor the outcomes of TPK funding for the Ākina Foundation (Ākina) – the country’s main social enterprise development agency – to deliver two pilot regional innovation hubs.

22. From November 2016, agencies will commence initial actions outlined in Table 1 (elaborated in Appendix E), and the cross-agency working group will firm up details, such as timelines and methodologies. As part of this discussion, the future lead agency should be considered – potentially MBIE, given links to regional and Māori economic development, international investment and financial markets legislation.

23. A key focus will be gathering data on social enterprises and services that support them, to inform the future work programme. Actions to coordinate government support, encourage investment, and promote social enterprise, will also feature.

Table 1: Initial actions for government

<table>
<thead>
<tr>
<th>Theme</th>
<th>Activity</th>
<th>Agencies</th>
<th>Rationale</th>
</tr>
</thead>
<tbody>
<tr>
<td>Measurement and research</td>
<td>Based on an agreed definition of social enterprise, develop a methodology for collating baseline data</td>
<td>Stats NZ, MBIE, DIA</td>
<td>Data collection would indicate the extent of social enterprise and its contribution to the economy. It would inform policy-making and build the sector’s profile with investors and consumers.</td>
</tr>
<tr>
<td></td>
<td>Determine a funding source for data collection</td>
<td></td>
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<tr>
<td></td>
<td>Researching the applicability of mainstream business supports to social enterprise</td>
<td>MBIE</td>
<td>The Strategic Group report suggests barriers exist to social enterprises accessing mainstream business supports. Anecdotally, it seems support from business accelerators is increasing.</td>
</tr>
<tr>
<td>Growing social enterprise capability</td>
<td>Monitor outcomes of current government funding for social enterprise development services</td>
<td>MBIE, TPK, MSD, DIA, MFAT</td>
<td>The primary barrier to social enterprise growth is the need for business skills. TPK, MSD and MFAT have contracts with Ākina to support a variety of outcomes, and DIA is providing a grant. Government contracts with, or grants to, Ākina currently total $1,254,700 in 2016/17 (from within existing funding sources).</td>
</tr>
<tr>
<td>Theme</td>
<td>Activity</td>
<td>Agencies</td>
<td>Rationale</td>
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<tr>
<td>Growing social enterprise capability</td>
<td>Pursue action to support the growth of Māori social enterprise</td>
<td>TPK</td>
<td>Further developing social enterprise may be valuable in accelerating Māori economic development. Ākina’s piloting of social enterprise regional hubs in Northland and Gisborne will provide data on the value of this approach.</td>
</tr>
<tr>
<td>Enabling social finance</td>
<td>Explore whether there is any legislative barrier to philanthropic trusts investing in social enterprises if rates of return may be sub-market</td>
<td>MoJ</td>
<td>Philanthropic trusts are unsure whether their fiduciary duties require them to always maximise financial returns. This can be considered in the context of trust law reforms through the new Trusts Bill.</td>
</tr>
<tr>
<td></td>
<td>Work with relevant philanthropic trusts as needed to help them understand financial markets regulatory requirements</td>
<td>MBI, FMA</td>
<td>A barrier to philanthropic trusts adopting social impact investment is their uncertainty about the range of regulatory requirements.</td>
</tr>
<tr>
<td></td>
<td>Consider an exemption from Anti-Money Laundering and Countering Financing of Terrorism Act (AML/CFT) requirements for the statutory Community Trusts if an application for an exemption is made</td>
<td>MoJ</td>
<td>One of the 12 Community Trusts established under the Community Trusts Act 1999 has obtained an exemption, and others may fulfil the same requirements. An exemption would encourage these trusts to provide social loans. MoJ is also ensuring its exemption processing is conducted more speedily.</td>
</tr>
<tr>
<td>Promoting social enterprise</td>
<td>Encourage participation in the SEWF 2017 in Christchurch</td>
<td>DIA, MBIE, TPK</td>
<td>This Forum will bring international experts and investors to New Zealand and will be a major event for Christchurch.</td>
</tr>
</tbody>
</table>
Reporting and review
24. Rather than duplicate governance structures, I propose that the cross-agency working group reporting be through the existing Senior Regional Officials’ Group and RED Ministers’ Group. By April 2017, a more detailed work plan, advice on ongoing leadership, and likely costs to agencies, will be provided by the cross-agency group to RED Ministers.

Consultation
25. This Cabinet paper has been prepared by the Department of Internal Affairs. The following agencies have been consulted: the Ministry of Business, Innovation and Employment, Office for Ethnic Communities, Financial Markets Authority, Ministry of Foreign Affairs and Trade, Inland Revenue, Ministry of Justice, Ministry of Pacific Peoples, Ministry of Social Development (including the Ministry of Youth Development), Social Investment Unit, Statistics New Zealand, Te Puni Kōkiri, and the Treasury. The Department of the Prime Minister and Cabinet has been informed.

Financial implications
26. The cost of the cross-agency working group will be met within existing agency baselines. The working group will consider financial implications of, and sources of finance for, relevant initiatives such as:
   • collecting data on social enterprises (beyond an initial scoping of definitions, which Stats NZ is able to undertake in November 2016); and
   • any Government contribution to a social impact investment fund.

Human rights, gender implications, disability perspective
27. This paper is consistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993. Some social enterprises employ people who are disadvantaged in the labour force.

Legislative implications and regulatory impact analysis
28. No Regulatory Impact Statement is required as no legislative changes are proposed.

Publicity
29. I intend to publish this Cabinet paper and related Cabinet decisions on the Department of Internal Affairs’ website, subject to consideration of redactions that would be justified if the information had been released under the Official Information Act 1982.

Recommendations
30. The Minister for the Community and Voluntary Sector recommends that the Economic Growth and Infrastructure Committee:
   1. note that activity across government to support social enterprise and social finance is increasing but that this is uncoordinated;
   2. agree to a cross-agency working group to coordinate work across a range of agencies to support social enterprise;
   3. agree that the Department of Internal Affairs initially lead this work, with the Ministry of Business, Innovation and Employment, the Social Investment Unit, and Te Puni Kōkiri as other core members of the working group;
4. **agree** to the initial actions in Table 1, related to measurement and research, growing social enterprise capability, enabling social finance, and promoting social enterprise;

5. **agree** that collection of baseline data on social enterprises, and information on support services, is a priority, in order to inform any future initiatives;

6. **agree** the cross-agency working group report to the Regional Economic Development (RED) Ministers’ Group and associated Senior Regional Officials’ Group;

7. **agree** the Minister for the Community and Voluntary Sector be invited to RED Minister’s meetings where social enterprise is an agenda item; and

8. **agree** a more formalised work programme, and ongoing leadership, be considered by RED Ministers by April 2017.

Authorised for lodgement

Hon Jo Goodhew
Minister for the Community and Voluntary Sector
APPENDIX A – The Nature of Social Enterprise

While there is no universally agreed definition of a social enterprise, these initiatives commonly:

- have a social, cultural, or environmental mission;
- derive a substantial portion of income from trade;
- reinvest all or the majority of profit/surplus in the fulfilment of their mission; and
- are separate from the state.

Social enterprises sit in the middle of a continuum between classic non-profit organisations and traditional for-profit businesses, as shown in the Strategic Group table below.

<table>
<thead>
<tr>
<th>Non-profit organisations reliant on grants and donations</th>
<th>Non-profit organisations with some trading activity</th>
<th>Social enterprises</th>
<th>Businesses with social responsibility policies</th>
<th>Traditional for-profit businesses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primarily incorporated societies and charitable trusts</td>
<td>May form as companies, incorporated societies, or charitable trusts</td>
<td></td>
<td></td>
<td>Primarily limited liability companies</td>
</tr>
</tbody>
</table>

Examples of social enterprises, detailed by the Strategic Group, are:

| Ākau | A company operating a design and architecture studio that engages youth in design projects. |
| Community and Business Environment Centre | A cooperative society with charitable status and nine trading arms, including a native tree nursery, public bus service, home insulation services, and four public swimming pools. |
| Indigo and Iris | An early stage company developing ethically sourced mascara and aiming to support services to treat blindness in the Pacific. |
| Kilmarnock Enterprises | A charitable trust with a business arm employing adults with intellectual disabilities, and providing pathways to sustainable employment. |
| Loomio | A cooperative company providing an online platform for community decision-making, and pursuing innovative investment models. |
| New Zealand Housing Federation | A charitable trust providing community housing across New Zealand. |
| Out of Our Own Backyards | A company providing locally-sourced food boxes, owned by a charitable trust. |
| Patu Aotearoa | A company providing fitness services to combat Māori and Pacific health problems. |
| Te Whangai Trust | A charitable trust employing at-risk people in its plant nursery and farms. |
| Whale Watch Kaikoura | A company running whale watching tours and providing grants to educational and environmental charities. |

This Government position statement acknowledges the value of the growing social enterprise sector and supports collaborative action to ensure social enterprises meet their full potential.

Social enterprises use commercial methods to support social or environmental goals. They principally reinvest surpluses in the social/environmental purpose rather than maximising profit for shareholders and owners. Potential benefits of social enterprise include innovative responses to societal issues, new employment opportunities, and sustainable income generation.

The Government is aware of the significant growth of the social enterprise sector internationally and wishes to support development of the sector in New Zealand. The Government acknowledges the innovation and entrepreneurship of this sector and the valuable contribution social enterprises can make to community strength and resilience.

Social enterprises can support a range of government goals including the development of a productive and competitive economy. The Government values the role of social enterprises as potential partners for a range of government agencies in achieving “collective impact”, and as contributors to Better Public Services goals involving third party service delivery.

The Government recognises that emerging social enterprises face a range of challenges, including the need for business advice and funding tailored to their hybrid social/commercial nature. The sector currently lacks a solid support infrastructure and many social enterprises struggle to access external finance.

The Government appreciates the importance of raising awareness of social enterprise, of taking action to help build capability, and encouraging finance for this emerging sector. Social enterprise networks, investors, philanthropic organisations, local authorities and central government agencies can all contribute to a future where social enterprises can flourish.

The Government, through its agencies, commits to identify any policy barriers to social enterprise growth and to work collaboratively to create an enabling, supportive environment where more social enterprises can grow and attract investment.
IN CONFIDENCE

APPENDIX C: Strategic Group Vision

IMPROVED SOCIAL, ECONOMIC AND ENVIRONMENTAL OUTCOMES

VISION

FLOURISHING SOCIAL ENTERPRISES AND A DYNAMIC SOCIAL FINANCE MARKET

Innovative and capable social enterprises

CAPITAL for all stages of social enterprise growth

PIPELINE of investable Social enterprises

INTERMEDIARIES
Social enterprise development; social finance brokerage

NEW AND EXPANDED PROVISION

Business development and capacity building
- Incubation, mentoring, advice
- Growth services and accelerators
- Investment/contract readiness
- Formal education courses
- Workshops, seminars, conferences
- Advocacy

Policy and Regulation

Research and measurement

NEW FORMS OF FINANCE FREED UP

Forms of finance
- Sales and contracts
- Development grants
- Crowdfunding – donations, equity, loans
- Loans/peer-to-peer lending
- Shares/community shares
- Bonds/social impact bonds

CAPABILITY BUILDING PROVIDERS
- Specialised agencies
- Mainstream business supports
- Networks/hubs
- Tertiary institutions
- Schools
- Iwi-based agencies
- Private trainers
- Local governments

SOURCES OF FINANCE:
- Specialised banks/fund-managers
- Mainstream banks/fund-managers
- Central & local government
- Philanthropic trusts
- High-net-worth individuals/family foundations
- Corporations
- Iwi
- Credit Unions
- Public, friends, family

Proactively released by the Minister for the Community and Voluntary Sector
APPENDIX D: Strategic Group Membership

Co-chairs:
- John McCarthy, Tindall Foundation
- Diana Suggate, Department of Internal Affairs

Members:
- Liz Gibbs, Philanthropy New Zealand
- Terri Eggleton, BayTrust
- Alex Hannant, Ākina Foundation
- Guy Ryan, Inspiring Stories
- Wayne Vargis, Te Rūnanga o Ngāi Tahu
- Michelle Sharp, Kilmarnock Enterprises
- Karyn Stillwell, Wellington City Council
- Jeffrey Stangl, Massey University

Advisory input: The Treasury
Secretariat: Department of Internal Affairs