Centre for
Social Innovation &
Impact Investing

EXECUTIVE SUMMARY

Social Venture Impact Investing: the Canadian Landscape

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THE UNIVERSITY OF BRITISH COLUMBIA

UBC SAUDER
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ABOUT THE UBC SAUDER CENTRE FOR SOCIAL INNOVATION & IMPACT INVESTING (SAUDERS3i)

The UBC Sauder Centre for Social Innovation & Impact Investing (SauderS3i) is focused on leveraging business tools to advance social innovation and sustainability, through research, incubation, and application. SauderS3i works closely with impact investors to advance the market in Western Canada, by providing high quality research, advisory work on capital allocation strategies, and building a pipeline of innovative social ventures.

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INTRODUCTION

"We are the first generation to be able to end poverty, and the last generation that can take steps to avoid the worst impacts of climate change. Future generations will judge us harshly if we fail to uphold our moral and historical responsibilities."

– Ban Ki-moon, Secretary-General United Nations 2007-2016

In the face of myriad issues, ranging from rising sea levels, declining affordability and widening inequalities, social innovation has emerged as a key pillar in designing solutions for complex social, environmental, cultural and economic problems. Social innovation manifests itself in many forms, from energy and infrastructure projects to policies and advocacy initiatives.

Many new approaches to tackling these entrenched problems have been developed through social ventures. In British Columbia, the number of social ventures grew by 35% between 2010-2015, with the number of for-profit ventures increasing by 42%.[1]

Growing in parallel with social innovation is the practice of impact investing: the deployment of capital towards assets that generate both a social or environmental impact, as well as a financial return. Impact investing activity has increased substantially in the past several years. The Global Impact Investing Network (GIIN) survey of impact investors indicates a near five-fold growth in assets under management earmarked for impact investing between 2014-2018.[2]

These two trends – the growing adoption of social innovation in change-making, as well as the merging of investments with social impact – have coalesced into a surge of investments into social ventures. Private equity and debt investments into social ventures consistently represent 20-40% of impact investments[3] - making them the most popular asset class.

At the Centre for Social Innovation & Impact Investing (SauderS3i), we have a long tradition of working with social ventures and impact investors. In 2012, the Coast Capital Savings Innovation Hub was established to support social entrepreneurs from the University of British Columbia to develop viable businesses with strong social missions. Subsequently, the UBC Impact Fund was created to provide investment capital into university student- or faculty-led social ventures. With the support of The McConnell Foundation, our experience designing and implementing these initiatives has led us to a new chapter: undertaking an extensive research project that examines the dynamics of impact investing in Canadian social ventures.

This report aims to provide a robust analysis of impact investing in Canadian social ventures. It is designed to answer three main questions.

[1] Centre for Social Innovation & Impact Investing. (2015) "BC Social Venture Sector Labour Market Study, 2015" https://www.sauder.ubc.ca/Faculty/Research_Centres/Centre_for_Social_Innovation_and_Impact_Investing/Knowledge_Hub/~/media/Files/ISIS/Reports/Social%20Venture%20Labour%20Market%20Study%202015.ashx

[2] Calculations based on GIIN's Annual Impact Investor Survey 2014-2018. This figure does not take into account a growth in the number of investors surveyed. The growth of total AUM adjusted by number of investors surveyed is 2.74x since 2014. https://thegiin.org/research

[3] Calculations based on GIIN's Annual Impact Investor Survey 2014-2018. https://thegiin.org/research

RESEARCH QUESTIONS

Our year-long research study was structured around the following three research questions. While this executive summary highlights the contours of the key findings, our full report provides details on our methodology and a more in-depth, nuanced analysis of the data. We encourage the reader to refer to the full report for further details.

RESEARCH QUESTION	DESCRIPTION
Demand-side: What is the market for social impact investments in social ventures?	We estimate the market size of the demand for social venture investment, as well as the major pain-points, friction points and barriers that social ventures face.
Supply-side: What is the appetite for social venture impact investing from investors?	We analyze the investment profiles of a variety of investors, ranging from foundations and family offices, to banks and insurance asset managers; exploring if and how social venture investments fit into their investment portfolios.
What can be done to better support social ventures in Canada?	We provide recommendations that address the issues facing stakeholders from both the demand and supply side.

1.0 DEMAND FOR CAPITAL: SOCIAL VENTURES

There is a substantial and growing demand for early-stage investment from social ventures in Canada.

To estimate the investment demand from social ventures, we created a database of 2,575 start-ups in Canada and identified 698 as social ventures across 74 cities and 10 provinces. The social ventures in the database raised an aggregate of 400 investment rounds, representing $1.59 billion in financing between 2007-2018. We estimate a *minimum universe* of $48M in average annual deal flow in pre-seed (grants, crowdfunding, family & friends) and seed investments. If we include Series A financing as well, the minimum universe grows to $159M annually (see Figure 2). This estimate is illustrative of the volume of investment deals we find if we just sourced from major incubators in Canada (mainly from BC, ON, AB, QC). As seen in Figure 1, the majority of investments are concentrated at the seed-stage, representing 208 investment rounds. Further insights and discussion on the database's limitations is provided in the full report.

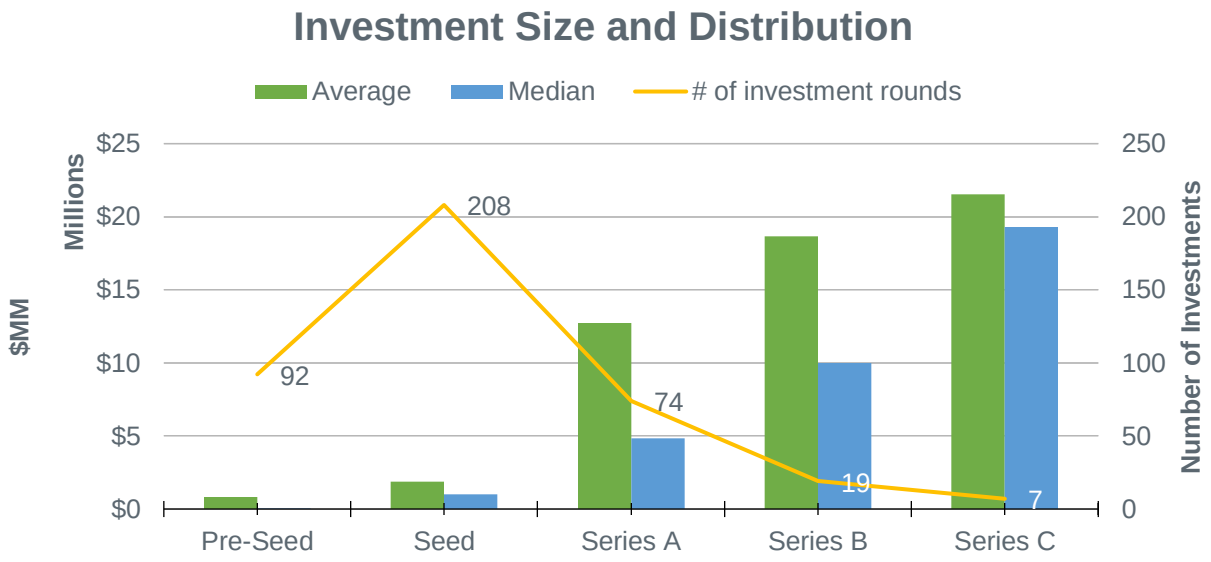


Figure 1. Investment size and distribution

Based on the social ventures retrieved from the 44 incubators, we estimate annual deal flow to range from $50M-$160M for early-stage investments. The estimate depends on how "early-stage" is defined.[4]

	PRE-SEED	PRE-SEED & SEED	PRE-SEED, SEED & SERIES A
Average Minimum Annual Deal Flow	$6.6M	$47.8M	$159.2M

Figure 2. Minimum annual deal flow estimates

[4] These figures are estimated based on taking the average of investment data from 2012-2017. Data from 2007-2011 is sparse as and likely not reflective of the true level of activity.

Early-stage social venture investing does not require large amounts of capital per deal. The majority of pre-seed funding opportunities were under $100,000 and were provided primarily by incubator or accelerators, government agencies, or crowdfunding platforms. Capital at this stage is generally used to develop a low-fidelity prototype to explore their target market, thus serving a critical role in early venture development. On the other hand, there is less consistency in the size of seed-stage rounds. Broadly speaking, seed rounds tend to be between $100,000-$2M, with a median of $1M.

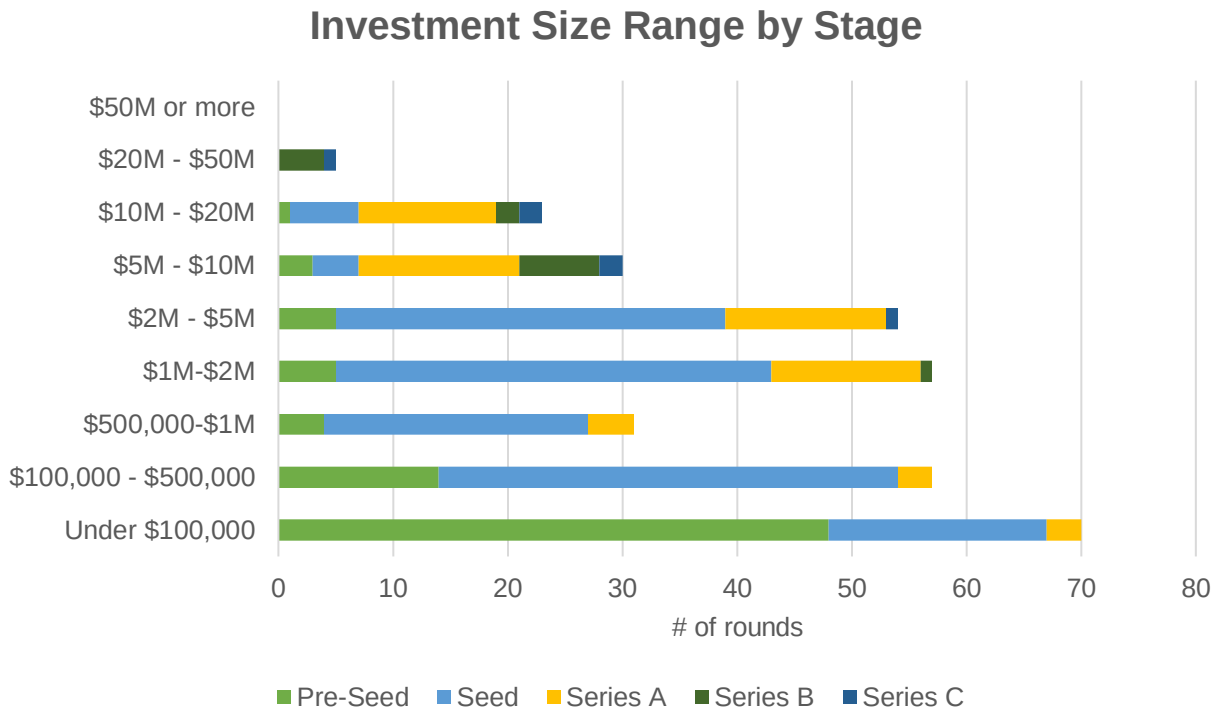
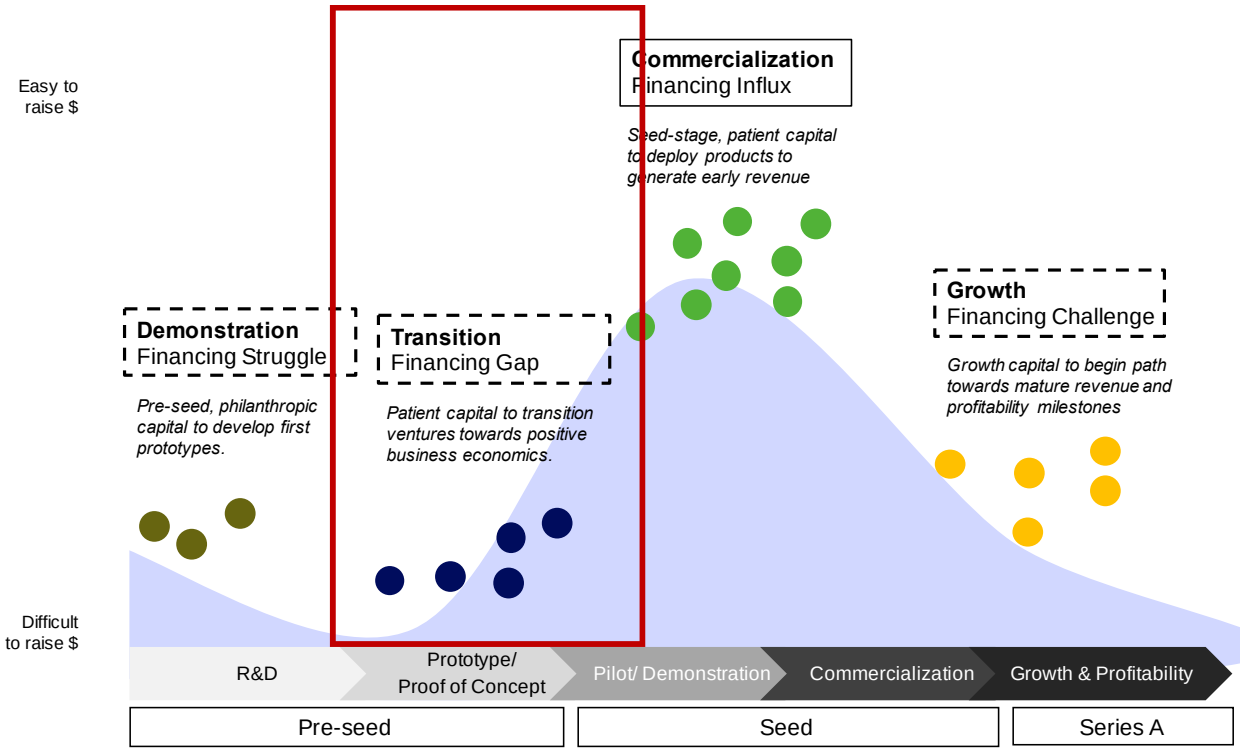


Figure 3. Investment size by stage



Early-stage ventures transitioning from "concept" to "business" face highest the greatest challenges when raising financing.

These social ventures have unique financing challenges depending on the stage of development. Through interviews with the founding teams of the social ventures, we identified four key stages of early-stage venture financing.

Demonstration Financing Struggle: Developing and demonstrating feasibility
It is worth noting that this stage is not labelled a financing "gap", as interviews have revealed that ventures believe there is an abundance of grants available. It is, however, difficult to identify which funding opportunities are relevant since the required use of grants does not always align with venture needs. For example, some grants prohibited ventures from hiring new staff despite their need for talent, but required the capital to be spent on technology development

Transition Financing Gap: Moving from pre-revenue stage to steady cash flows
At this stage, ventures tend to be transitioning from a pre-revenue to a revenue stage. They have identified a cost-effective method of building their product and have a clear understanding of their target market, but they have yet to obtain an established customer base. While they have a strategy to deliver the necessary metrics (sales revenue, number of users, positive unit economics), the capital available to them is not quite adequate: grants, crowdfunding, and "family and friends" rounds are too small to help them achieve the scale they need, and larger, more structured seed funds consider them too early and too risky for investment.

At this stage, if the ventures receive capital that is not suitable for their business model (e.g. capital with expectations of short-term gain), the venture may result in developing a structure to fit the needs of the investment. Well-designed pre-seed capital would provide investments that act as the venture's stewards; investment that aims to *generate* impact, not solely to *extract* returns.

Commercialization Financing Influx: A "honeymoon" period for social ventures
Ventures have a product that is fully-developed and built with positive unit economics at this

stage. They have established a substantial customer base and are beginning to build significant traction in sales. While ventures at this stage tend to face fewer barriers to raising financing, some interviewees cite challenges they foresee in the near future. With ambitious goals to grow their product offering, or expand into other markets, some ventures were unsure whether they would be able to finance their growth organically, or whether they would eventually need a growth round of investment.

Growth Financing Challenge: Achieving Series A-stage financial benchmarks
At this stage, ventures are beginning to qualify for Series A financing, thereby opening up channels with more "mainstream" investors such as Silicon Valley venture capital funds, or structured financing from major banks and other financial institutions. The issue that ventures face at this point is meeting the metrics and thresholds that these sources of capital demand. Milestones such as number of users or revenue are required for them to access the necessary growth capital. For ventures that are close but have not achieved those milestones, they face major hurdles at this stage.

To best serve these early-stage social ventures, we need capital with the following features:

STAGE	TIME HORIZON	RISK TOLERANCE REQUIRED	RETURNS	TICKET SIZES	CAPITAL TYPE & AVAILABILITY
Demonstration Financing Struggle	Long	High	Concessionary, Potentially negative	$10,000-$50,000	Type: Grants, Family & Friends Availability: Available but fragmented
Transition Financing Gap	Long	High	0-5%	$50,000-$100,000	Type: Angel investors, family offices, some foundations Availability: Large gap
Commercialization Financing Influx	Medium	High	Varies	$100,000-$500,000	Type: Seed Funds, individual angel investors Availability: Adequate
Growth Financing Challenge	Medium	Medium-High	Varies	$500,000-$2M	Type: Venture capital funds, foundations Availability: Moderate

SUPPLY OF CAPITAL: IMPACT INVESTORS

There is material interest from various types of investors to allocate capital for social venture impact investing.

The vast majority of the investors we analyzed and interviewed indicated a significant interest in allocating capital towards impact investing in social ventures (only 10/37 organizations did not have any mention).

Responsible or impact investment units manifest in various forms for different investors. We propose three models as examples below.

Through the analysis of the investors' Investment Policy Statements, fund performance reports, financial statements and related documents, we recognized that many investors are moving away from a model of solely "considering" social and environmental factors, and instead are actively earmarking capital for stand-alone funds or developing new departments to focus on impact investing.

MODEL	% OF INVESTORS STUDIED	DESCRIPTION
Considered	41%	The impact investing practice resides inside another unit; usually the investment arm. Tools such as ESG ratings, screening and carbon profiles are "considered", but are not a core decision factor for investments. There remains a divide between the 'mainstream' capital investment decisions and impact investment allocations. Only a small percentage of their capital is earmarked for responsible or impact investments, while the rest is managed in a traditional manner.
Committed	27%	A separate unit committed and focused on a specific function/ mandate related to impact investing. These models are often a 'sandbox' for the organization to test out impact investing concepts.
Core	5%	The investment operations of the organization are completely managed within responsible and impact investment principles. These organizations have a stated goal of managing the majority (if not all) of their capital in a manner that aligns with their values. Few organizations have been able to achieve this level of commitment.

Figure 4. Approaches to responsible and impact investing

An influential factor is an investors' appetite for social venture impact investing is their asset allocation policy. We found patterns in asset allocation based on the nature of the investment organization. For instance, values-based organizations such as foundations have dual priorities to ensure they have the ability to meet financial obligations to their community, while growing their endowment for the future in a manner that aligns with their values. Similarly, risk-taking arms of mainstream investors (such as corporate venture capital arms) are mandated to make *strategic* investments that go beyond providing stable income to the parent company. As a result, these two types of investors have the most diverse portfolio make-up of the investors analyzed – they have exposure to asset classes from government-backed fixed income investments to private equity and venture capital.

TYPE	BONDS[5]	EQUITIES	REAL ASSETS/ REAL ESTATE[6]	ALT. IMPACT PRODUCTS[7]	PE/ VC
Organizations involved with impact investing (Community & private foundations)	37.28%	51.75%	3.13%	2.00%	3.69%
Values-based organizations with traditional grant/investment structure (Indigenous trusts)	48.13%	51.67%	13.50%	n/a	n/a
Risk-taking arms of mainstream investment organizations (corporate VC, insurance investment divisions)	69.23%	13.94%	18.75%	Yes[8]	12.00%
Mainstream investment organizations (endowments, pension funds)	35.08%	45.44%	21.28%	n/a	n/a

Figure 5. Asset allocation distributions comparison

The full report provides detailed analysis of the investors' assets under management, return expectations, risk tolerance, and exposure levels to various asset classes. While there is expressed interest in impact investing, the reality is that social venture investing is still a risky and uncertain practice. This points to a need for innovative funds to be designed to fit the investors' and ventures' needs in order to build a track record for social venture capital as an asset class.

[5] Includes money market, loans, cash and cash equivalents
[6] Includes infrastructure projects, affordable housing mortgage funds, green bonds, renewable energy projects
[7] Includes Social Impact Bonds, recoverable grants, loan guarantees
[8] We were unable to find exact numbers but these organizations have made investments in social impact bonds.

There is a role for a national "Social Values" fund.

The reality is that social ventures do not yet represent an asset class that can replace the traditional investments of impact investors. Nonetheless, many investors surveyed indicated they are planning (if they have not already) to allocate capital towards supporting businesses with a social impact mission on a national scale.

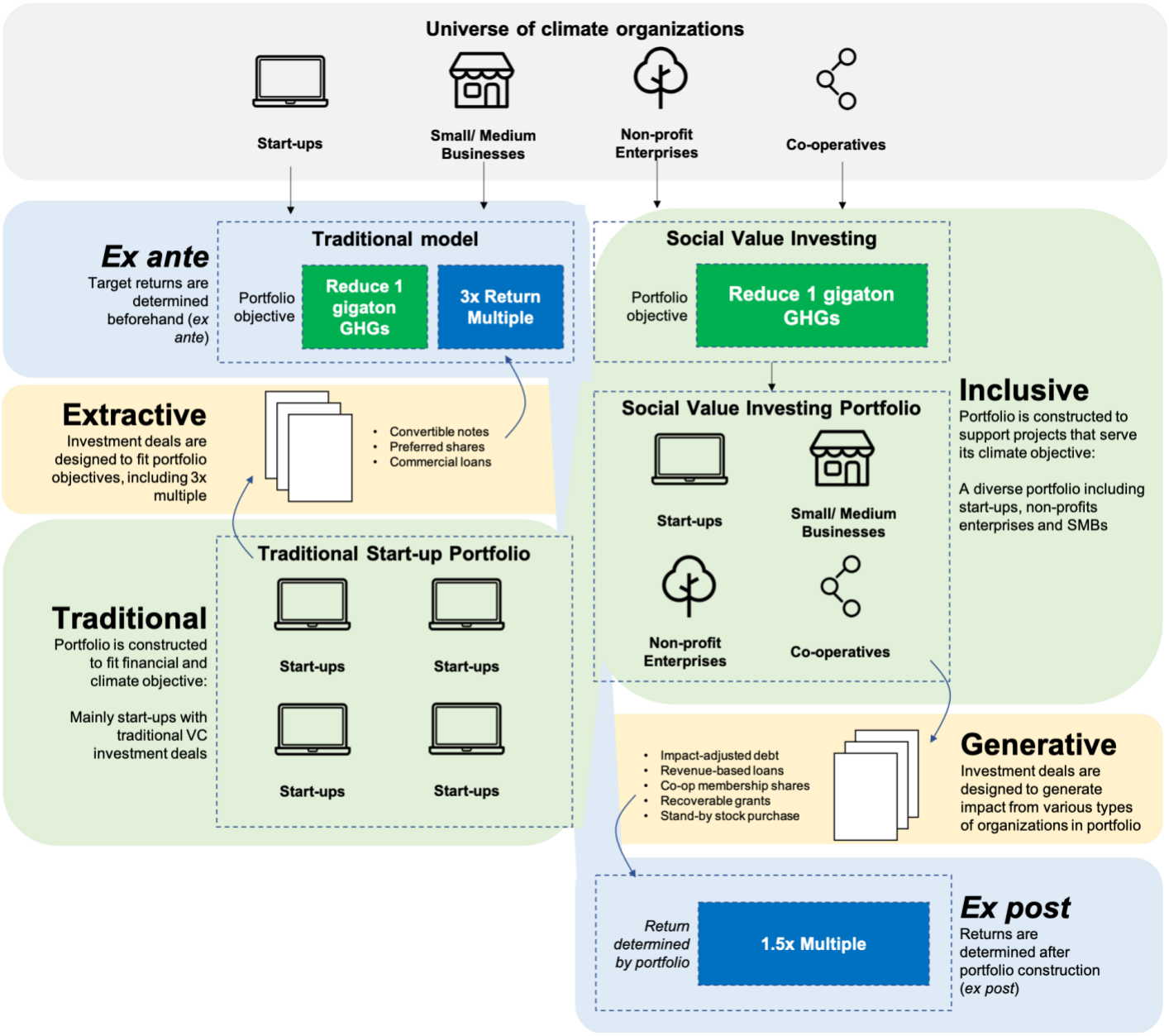
Although some investors are constrained from investing nationally due to geographic restrictions, there is substantial interest in developing a robust national infrastructure to identify high-potential social ventures across regional communities. Furthermore, a model – "Social Value Investing" (a term coined by Helder Ventures) – has begun to gain popularity amongst the investors we interviewed. "Social Value" investments are distinguished from traditional venture investments based on three characteristics:

- **Inclusive Impact:** Investments prioritize a venture's ability to contribute to solutions, and not their financial profitability potential. This allows social value investors to be inclusive of their definition of social venture investing to include small-medium businesses, enterprising non-profits, cooperatives, or even traditional technology ventures that have the potential to adapt their product to serve a social or environmental issue.

- **Generative, impact-adjusted returns:** The investment deal design is venture-centred, meaning investors primarily view their capital as a service to the investees' mission. The capital providers are stewards of the venture and not acting as a principal-agent (or "shareholder-investee") relationship. The investment prioritizes the *generation* of impact, and does not solely focus on the *extraction* of returns. As seen in the 10th Avenue ICP deal, at times the returns are adjusted to incentivize impact-based milestones.

- ***Ex-post* returns:** The financial return is largely determined "after-the-fact" (*ex post*) by the ventures' specific traits, characterized by their business model and Theory of Change. This results in a diverse set of investment deals, ranging from innovative structures like demand dividends, revenue-based loans and impact-adjusted returns, to more established designs such as convertible notes, recoverable grants or loan-loss guarantees. In contrast, a traditional fund determines their return "before the fact" (*ex ante*) and screens investments based on some pre-determined financial hurdle rate. As a result, many of the investment deals are designed with features like equity conversion and liquidation preferences to achieve the financial objective.

The figure below illustrates the SVI model compared to traditional impact investing, and explained in the further detail here.


Universe of climate organizations
Start-ups
Small/ Medium Businesses
Non-profit Enterprises
Co-operatives
Ex ante
Target returns are determined beforehand (ex ante)
Traditional model
Portfolio objective
Reduce 1 gigaton GHGs
3x Return Multiple
Social Value Investing
Portfolio objective
Reduce 1 gigaton GHGs
Extractive
Investment deals are designed to fit portfolio objectives, including 3x multiple
Convertible notes
Preferred shares
Commercial loans
Social Value Investing Portfolio
Start-ups
Small/ Medium Businesses
Non-profit Enterprises
Co-operatives
Inclusive
Portfolio is constructed to support projects that serve its climate objective:
A diverse portfolio including start-ups, non-profits enterprises and SMBs
Traditional
Portfolio is constructed to fit financial and climate objective:
Mainly start-ups with traditional VC investment deals
Traditional Start-up Portfolio
Start-ups
Start-ups
Start-ups
Start-ups
Impact-adjusted debt
Revenue-based loans
Co-op membership shares
Recoverable grants
Stand-by stock purchase
Generative
Investment deals are designed to generate impact from various types of organizations in portfolio
Return determined by portfolio
1.5x Multiple
Ex post
Returns are determined after portfolio construction (ex post)

RECOMMENDATIONS

The Canadian impact investment community has grown considerably over the past decade.

The Canadian impact investment community has grown considerably over the past decade. With pioneering leaders such as The McConnell Foundation, MaRS Centre for Impact Investing, Rally Assets, and Renewal Funds, as well as more recently developed organizations such as Active Impact Investments, the VERGE Breakthrough Fund, and 10th Avenue ICP, the amount of work dedicated towards supporting social ventures is substantial.

Nonetheless, there is room for improvement. Our research provides an in-depth examination of the social venture ecosystem in Canada and has highlighted several key issues, as summarized in the previous section. In this section, we do not wish to prescribe specific solutions, but hope to provide some guidelines for how capital could be designed to better support social ventures in Canada. The tables below summarize the key design principles in mind.

To better serve ventures…

FACTOR	DESCRIPTION	RECOMMENDATIONS
Business Type	Impact is generated not only by "start-ups" but also by grassroots organizations, small businesses, and enterprising non-profits.	Recognize impact can be generated by businesses of all shapes and sizes. Even if the venture's product is not necessarily contributing to solving an issue, positive impact can come from adapting the product, improving the company operations, or providing support to the community and stakeholders.
Return	Unlike green bonds or real estate funds, social venture capital is riskier with less certainty towards factors such as liquidity. Overly aggressive terms to achieve market returns can end up being detrimental to the venture's mission.	Consider targeting "impact-adjusted returns" which uses the investment capital *as a service* to the venture's impact mission. For example, the capital can play an influential role in encouraging more equitable, just and sustainable management practices. The investment should *generate* impact, not *extract* returns.
Deal Design	Investing into social ventures is inherently risky. "Aggressive" mechanisms to extract value from the investment and protect the investor from downside risk may be inappropriate for supporting early-stage social ventures.	The investment deal should serve the venture's business model, not the other way around. Innovative financing mechanisms such as impact-adjusted loans, revenue sharing, and demand dividends can be used to design investee-friendly deals.
Stage	We identify three main friction points: Demonstration, Transition, and Growth. Each of these stages require different types of financing.	A variety of sources of capital is needed to serve Canada's social ventures. Consider a blended finance approach that provides a range of capital: for example, a base layer of philanthropic capital to absorb risk (for "Demonstration" stage ventures); mezzanine debt that utilizes innovative financing mechanisms (for "Transition" ventures); and friendly bridge deals to help ventures transition towards mainstream Series A financing (for "Growth" stage ventures).
Business Support	Almost all the early-stage ventures we interviewed cited a large need for business support and mentorship. This was especially common for niche products and services; whose ventures need a wide range of support services.	The most common needs include support in sales, marketing, human resources and talent recruitment.

To better serve investors…

FACTOR	DESCRIPTION	RECOMMENDATIONS
Outcomes Focus	Canada faces a myriad of issues, spanning multiple sectors. New funds must also account for the fact that different investors have different approaches to impact investing, and are grounded in achieving specific outcomes.	Each region has their unique set of characteristics, from their public and legal policies, to their culture, and their community resources. Utilizing a community's knowledge to define a fund's desired outcomes is key.
Geographic Focus	There are many investors focused on regional outcomes in their local communities, while others are more nationally-focused (or perhaps internationally). A fund must understand this dynamic and cater to these varying needs.	There is a clear desire for a robust pipeline of social ventures that is "National in Scale, Local in Scope". Investors can tap into this pipeline to understand the activity within their own community, while also monitoring what other ventures are doing across the nation.
Investment Committee	Credibility and trust are instrumental in helping an investor decide to allocate capital towards social ventures.	An experienced and credible investment committee is extremely important. The investment committee should be experienced in not only investing, but also the targeted social/environmental issue(s) itself (themselves).
Catalytic Capital	Catalytic capital can include loan guarantees, anchor investments, first-loss reserves, or tax credit incentives. These "sweeteners" can help reluctant investors overcome the financial hurdles preventing them from investing in social ventures.	Explore opportunities for investors or intermediaries to provide catalytic capital, instead of just pursuing a traditional fund model. Taking this action could result in a leveraging effect that would catalyze other investments.
Transaction Costs	Many investors lack the internal capacity to hire a team of seasoned analysts. Transaction costs should be kept low to attract these impact investors.	Management fees should be kept below 2% to ensure cost effectiveness for investors, particularly in the case of concessional returns. The cost structure, however, should not be designed at the expense of high-quality research and analysis.
Return Expectations	The returns should be reasonable to both the investor and portfolio companies. We identified a potential segment of investors – "Social value investors" – that targets 0-5% returns.	Consider a portfolio-determined return: instead of having a pre-determined (*ex ante*) return hurdle rate, design the return expectations that are appropriate for the impact of the investee companies (*ex post*).
Liquidity	While there are many patient investors, it is important to consider liquidity concerns. Increasing liquidity can also help build a positive track record for social venture investments.	Consider designing mechanisms to increase the liquidity of social venture investments, through means such as innovative loan structures, or a secondary market for venture investments.

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