

Building Blocks for Strong Communities

Key Findings and Recommendations

Mark Goldenberg

A research report prepared for Human Resources and Social Development Canada
March 2006



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Imagine Canada
425 University Avenue, Suite 900
Toronto, Ontario M5G 1T6
Tel.: (416) 597-2293
Fax: (416) 597-2294
www.imaginecanada.ca

Canadian Policy Research Networks
600-250 Albert Street
Ottawa, Ontario K1P 6M1
Tel.: (613) 567-7500
Fax: (613) 567-7640
www.cprn.org

ISBN 1-55401-237-6

Funding for this paper was provided by the Community Development and Partnerships Directorate of Human Resources and Social Development (HRSD) Canada. The opinions expressed in this paper do not necessarily reflect the views of HRSD.

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Preface

This report is one of four produced by Imagine Canada and the Canadian Policy Research Networks (CPRN) as part of a study of small- and medium-sized enterprises (SMEs) and small- and medium-sized community organizations (SMOs) in Canada.

The study compared the structure, development and supports for SMEs and SMOs in Canada and also examined supports available to SMEs and SMOs in other countries. Drawing on learnings from Canadian and international experience, the study made recommendations on how public supports for SMOs in Canada could be improved.

The other three reports produced as part of this study are:

Building Blocks for Strong Communities: A Profile of Small- and Medium-sized Organizations in Canada;

Building Blocks for Strong Communities: A Profile of Small- and Medium-sized Enterprises in Canada; and

Building Blocks for Strong Communities: Results of Key Informant Interviews.

Acknowledgements

The author would like to acknowledge a number of people who contributed to this research and to the preparation of this report.

At Imagine Canada, Georgina Steinsky Schwartz, Michael Hall, Robbin Tourangeau and Cathy Barr provided overall direction and ongoing advice throughout the project. Glenn Gumulka was responsible for the day-to-day management of the project. Stephen Hay, David Lasby, Lesley Gotlib Conn and M. Easwaramoorthy assisted with various project activities.

At the Canadian Policy Research Networks, Judith Maxwell, Sharon Manson Singer and David Hay provided overall direction and ongoing advice throughout the project. Susan Carter and Emily Hines were responsible for key project activities.

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Introduction

The well-being and quality of life of Canadians depend in large measure on the roles played by family, community, the market and the state, the strength of each and the inter-relationships among them.¹ In this, both small- and medium-sized enterprises and small- and medium-sized community organizations play critical roles.

Small- and medium-sized enterprises (SMEs) are an essential part of Canada's private sector. They account for the vast majority of businesses in Canada, represent over 60% of private-sector employment, and generate more than 80% of new job creation.

In similar fashion, small and medium-sized organizations (SMOs) are the driving force of a vibrant social or community sector in Canada, account for over 99% of community organizations, and make a vital contribution to the Canadian economy.

Imagine Canada and Canadian Policy Research Networks (CPRN), with the financial assistance of Social Development Canada (now Human Resources and Social Development Canada), have undertaken a comparative study of SMEs and SMOs in Canada: their key characteristics and contributions to society and the economy; factors influencing their growth and development; and public supports available to them. The research study also looks at the experience of other countries with regard to SMEs and SMOs.

The Imagine-CPRN study notes that governments in Canada and internationally began to recognize the contribution of SMEs to the economy in the 1980s, and over the last two decades have undertaken extensive information-gathering and research about SMEs and put in place an impressive array of policies and supports for them.

This Imagine Canada-CPRN study . . .

Examines small- and medium-sized organizations in Canada – organizations with less than 500 paid staff

Compares small- and medium-sized enterprises (SMEs) and community organizations (SMOs)

- their key characteristic
- contribution to society and the economy
- success factors
- public policies and supports

Makes recommendations to improve public supports for SMOs based on the comparative analysis with SMEs, the particular characteristics and needs of SMOs, and learnings from other countries

The methodology for the study includes literature reviews, data analysis, a review of international experience and key informant interviews.

¹ See Canadian Policy Research Networks (CPRN) discussion of the “well-being diamond” (Jensen, 2004).

Governments have come somewhat later to understand the economic contribution of SMOs, as well as their significance as an anchor of community health and vitality and their potential for social innovation, and have developed policies and undertaken initiatives to better support SMOs in their role in society. Recently, for example, the Government of Canada announced, in the 2004 Budget, initiatives aimed at research, capacity-building and improved financing supports for community economic development and social economy organizations, and the intention to give them access to some SME program supports. This research study underscores, however, that our knowledge about SMOs and the public supports available to them lag far behind what we know about SMEs and the supports available to them.

Community organizations are on the front lines of every important social, cultural, environmental and community issue in Canada. They run homeless shelters and food banks, provide child care and deliver meals-on-wheels, coach hockey and synchronized swimming, build bike paths and mark trails, clean rivers, run hot lines, welcome newcomers, and serve Canadians in countless other ways in order to respond to their needs and help them participate fully and activity in social, economic, community and civic life. It would be difficult to find a single Canadian who has not benefited from the work of community organizations.

And, increasingly, governments at all levels rely on community organizations to deliver essential public services. Governments have come to be, in some ways, “clients” of organizations, and have a special relationship with them.

Yet, despite their critical importance, many community organizations in Canada are struggling to effectively play their role in society and realize their full potential to do so. Those in the sector are faced with increased service demands, dwindling financial resources, shoe-string operating budgets, staff burn-out, and other serious challenges to their ability to serve Canadians and their communities.

Based on analysis of the research findings, and drawing on learnings about SMEs and SMOs in both Canadian and international experience, the Imagine-CPRN study presents a number of recommendations on how to improve public supports for SMOs in Canada, recognizing that, as in the case of SMEs, more needs to be known about SMOs and better and more comprehensive supports will need to be put in place over a period of time.

Key conclusions of this study

SMEs and SMOs dominate the business and community sectors in Canada and make a significant contribution to society and the economy

SMEs and SMOs have important similarities but also key differences in terms of their characteristics and success factors

Our understanding of SMOs and public supports for them lag far behind our knowledge of SMEs and supports for them

SMOs are the anchor of community life, health and well-being in Canada. They deliver key services to Canadians, including many services on behalf of government; facilitate participation in democratic life; foster social innovation; and make a significant contribution to the economy

Many SMOs are struggling to perform their role and face significant barriers to maximizing their contribution

Canada needs to build, over time, a comprehensive set of public supports for SMOs, drawing on learnings from Canadian and international experience with SMEs and SMOs and based on better data and knowledge.

Methodology and Definitions

The methodology used for this research included literature reviews, analysis of available data, and key informant interviews.

The study defines SMEs and SMOs as organizations with less than 500 paid staff, in line with commonly used definitions for SMEs by governments and in the literature.

The term “community organizations” is used broadly to include a wide variety of nonprofit organizations in Canada: charitable and voluntary organizations; para-public organizations such as hospitals and post-secondary education institutions; and social economy organizations, community economic development organizations, and co-operatives. Comparable data is not however available for all types of organizations. Whatever their differences in terms of structure, activities, orientation or mission, community organizations in Canada all possess a number of key characteristics, including the following: they are self-governing, independent from government, do not return profits to their owners or directors, are voluntary in nature, and are usually incorporated or registered under federal or provincial/territorial legislation.²

The results of the research study are presented in separate reports on SMEs and SMOs in Canada and the highlights of the key informant interviews.

This report summarizes the **key findings and policy recommendations**.

Key areas to improve public supports for SMOs in Canada

Improving data, knowledge and understanding of SMOs

Providing information, tools, advisory and support services

Facilitating and leveraging access to financing and improving public funding supports

Supporting innovation and technology

Supporting networking and partnerships

Addressing regulatory and other concerns.

² National Survey of Nonprofit and Voluntary Organizations (NSNVO).

A Note on Sources

This paper presents the key findings and recommendations from Imagine Canada and Canadian Policy Research Networks' comparative study of small- and medium-sized enterprises (SMEs) and small- and medium-sized community organizations (SMOs) in Canada. As such, it draws heavily from two research papers prepared as part of the study:

Building Blocks for Strong Communities: A Profile of Small- and Medium-sized Enterprises in Canada. This paper reviews the major current literature and research available on SMEs in Canada, as well as literature on SMEs in other countries.

Building Blocks for Strong Communities: A Profile of Small- and Medium-sized Organizations in Canada. This paper reviews the major current literature and research on the charitable and nonprofit sector in Canada, as well as literature on the sector in other countries. It also presents an in-depth analysis of the sector based on data from the National Survey of Nonprofit and Voluntary Organizations (NSNVO) and data from Canada Revenue Agency (CRA) T3010 information returns.

Both these papers contain extensive references and bibliographical information about the sources used in this study of SMEs and SMOs.

The paper also draws on the results of interviews conducted with individuals who have extensive knowledge and experience in the business and/or community sectors. A fuller discussion of those interviews can be found in: *Building Blocks for Strong Communities: Results of Key Informant Interviews*. This synthesis paper includes references to key documents and data sources for the major findings and conclusions presented in the paper. The reader is encouraged to consult the three papers noted above, as well as the sources cited in them, for further information, data and analysis.

Why support SMOs?

Over a number of years, governments in Canada and in other countries have put in place a significant array of policies and supports for SMEs. A two-fold rationale is the basis for this public support: first, SMEs' contribution to the economy and job creation; and, second, the need to compensate for market imperfections that mean SMEs are systemically disadvantaged or limited in access to private-sector financing and other supports.

Research suggests a number of key rationales for public policies to support SMOs. These reflect similar rationales as exist for SMEs, as well as considerations relating to the special characteristics and roles of SMOs in Canadian society.

FIRST, SMOs HAVE A SIGNIFICANT ECONOMIC IMPACT. As detailed in the report on SMOs in Canada, SMOs possess significant assets and resources and make a very important contribution to the Canadian economy.

SMOs create jobs for the more than one million Canadians who work in them. They deliver programs and services that contribute to local and regional economic growth and development, resulting in important employment and economic benefits in communities across Canada and stimulating local economies and generating tax revenues.

SECOND, SMOs PROVIDE KEY SERVICES TO CANADIANS AND CONTRIBUTE DIRECTLY TO THE QUALITY OF LIFE AND WELL-BEING OF THEIR COMMUNITIES. Active in almost every feature of social and economic life, present in every community across Canada, with many tens of thousands of organizations and hundreds of thousands of volunteers and able to mobilize citizens and local resources, SMOs make a vital contribution to community life in Canada.

SMOs deliver essential community services in key areas of society and the economy, from child care to elder care, from sports programs to religious activities to theatre companies, from employment and counselling programs to the environment, responding to real needs identified by Canadians and their communities. Acting in the area between the state and the market, they can provide services that are not profitable or appropriate for the private sector to deliver and that the public sector does not provide or cannot deliver as effectively or efficiently. They also deliver critical supports and services to marginalized and disadvantaged Canadians.

With deep roots in the communities they serve and extensive local knowledge, SMOs have the potential to deliver effective *place-based* policies and services, mobilizing local resources to

Why support SMOs

SMOs have a significant economic impact. They employ one million Canadians, generate important revenues and contribute to local and regional economic development

SMOs are an anchor for community life, health and well-being. They deliver key services and mobilize community resources and leadership in finding solutions to community and individual problems

SMOs foster citizen participation and engagement, the development of social capital, and a healthy democracy

Increasingly, governments at all levels are turning to SMOs to deliver important public services to Canadians

SMOs are a leading force for social innovation at the community level in Canada, finding creative ways to address social and economic challenges.

address complex social, economic and environmental issues through community leadership and decision-making and innovative solutions that cut across sectors and jurisdictions.

Charitable and nonprofit organizations are an anchor for community life, giving Canadians multiple and on-going opportunities to participate in social, economic, cultural, artistic, recreational, religious and virtually all other areas of endeavour, and in civic and public affairs.

THIRD, SMOs PLAY A CRITICAL ROLE IN FOSTERING CITIZEN PARTICIPATION AND ENGAGEMENT AND A HEALTHY DEMOCRACY. SMOs provide important opportunities and means for citizens to participate actively in society and public affairs.

Community organizations are a meeting place for people to work, learn and play together. They enable citizens and communities to organize themselves in areas of shared interest and concern in order to address common challenges, pursue shared dreams, and give expression to deeply-held values. They can help people build networks and relationships, learn and develop skills, and share knowledge. Their democratic structures, openness and involvement in the community provide potential for the empowerment of both users of their services and of volunteers and employees in the organizations themselves.

SMOs provide an important means of democratic expression and participation, representing the interests of individuals and communities to government and helping citizens to talk to government and government to reach citizens. They often speak on behalf of the disadvantaged and marginalized in society, giving a voice to those who are voice-less.

In sum, SMOs help build social capital and a shared sense of citizenship and inclusion and contribute to a healthy and vibrant democratic life in Canada.

FOURTH, SMOs DELIVER IMPORTANT PUBLIC SERVICES ON BEHALF OF GOVERNMENTS IN CANADA. Increasingly, all governments in Canada are turning to community organizations to deliver a large number and variety of public services.

SMOs have many strengths that enable them to deliver services that the state cannot provide as effectively or efficiently. They draw upon the commitment and talent of many hundreds of thousands of volunteers every day. They have deep roots in the communities they serve, and their on-the-ground presence gives them in-depth knowledge of those communities and the challenges they face. They are well connected through formal and informal networks in the community, with government, business, education and private-sector partners and can mobilize community resources. With adequate and appropriate resources, they can be flexible and responsive, working close to the people they serve and tailoring programs and services to meet the real needs of real people, “translating” government programs and criteria to respond to local and individual circumstances – as long as governments allow them the flexibility to do so! They are able to work horizontally and holistically across different sectors of the economy and society and across the jurisdictions of the federal, provincial/territorial, regional/local and municipal governments, and to bridge the social and economic and environmental worlds.

FINALLY, SMOs ARE A VITAL SOURCE OF SOCIAL INNOVATION, FINDING CREATIVE WAYS TO ADDRESS SOCIAL AND ECONOMIC PROBLEMS FACED BY COMMUNITIES AND INDIVIDUALS. The voluntary and charitable sector has long been a powerful force for social innovation in Canada, giving birth to our earliest schools, hospitals and universities, and leading the way to many of the public programs in the health, social, economic and education areas that Canadians value today. The sector also often serves as an “early warning” system, identifying and articulating emerging

social issues (e.g. environmental issues in the 1960s and 1970s and HIV/Aids in the 1980s) and mobilizing individuals, communities and resources to begin to address them.

SMOs are uniquely well qualified to foster and lead social innovation in Canada at the community level. They can bring to social and economic challenges in-depth knowledge of the community, hands-on experience and expertise, flexibility and responsiveness, creativity, and a holistic approach, some of the very ingredients essential to social learning and innovation. How SMOs are especially well positioned to lead community social innovation is discussed further in the next section of this paper, as well as in the background paper that provides a detailed profile of SMOs in Canada.

Examples abound of successful innovations led by SMOs, in all fields of endeavour and in communities across the country, e.g. a Latin American Diabetes Program in London, Ontario to address the disproportionate impact of diabetes on Latino people, which won the 2002 Peter Drucker Canadian Award for Canadian Nonprofit Innovation; a Foodshare community business in Toronto that makes fresh food available to those in need in a way that does not stigmatize people; innovative school programs in the east end of Montreal targeting social skills development in order to help reduce excessively high school drop-out rates among males.

SMEs and SMOs in Canada – Key Characteristics

SMEs and SMOs in Canada demonstrate important similarities as well as significant differences.

The characteristics of SMEs and SMOs described below are drawn from the data, information and analysis in the supporting papers prepared as part of this research study.

Although various definitions exist for SMEs, for the purposes of this study both SMEs and SMOs are defined as organizations with less than 500 paid staff, in line with commonly used definitions for SMEs. The supporting papers provide further information on different definitions used in Canada and internationally.

The key distinction between SMEs and SMOs, of course, is whether they are for-profit or nonprofit. At the same time, given the economic impact of SMOs that is now increasingly being recognized and the rise of social entrepreneurship and the social economy, both in Canada and internationally, the boundaries between SMEs and SMOs may be somewhat blurred, opening up new considerations for policy-makers interested in supporting and growing the sector, and for SMOs themselves.³

A further significant difference between SMEs and SMOs is their use of volunteers.

While some SMEs may, of course, have unpaid family members or others who work in the enterprise, volunteers are the life-blood of SMOs, and most organizations rely heavily on them to deliver their mission.

Community organizations in Canada

The community sector in Canada is often referred to by different names, including the “nonprofit” or “charitable” or “voluntary” sector, the “third” sector, or “civil society”

This paper uses the term “community organization” in a very broad sense to include the following general categories of nonprofit organizations:

- charitable and voluntary organizations that pursue a wide range of social, community and public policy interests
- community economic development organizations that seek to mobilize local resources to stimulate economic opportunities
- social economy organizations that are active in the market place and produce goods and services in order to respond to social and community needs
- co-operatives, that are organizations owned and operated by their members and that pursue both a social and economic purpose

Quasi-public nonprofit organizations such as hospitals, colleges and universities – the so-called “quango” sector (quasi-autonomous non-governmental organizations) – are included within this broad definition

The boundaries across these different categories are fluid. For example, most organizations in all of the above categories have an important volunteer dimension, and many voluntary, economic development and co-operative organizations can be seen as part of the social economy broadly speaking

Comparable data is not always available for organizations across the sector. The paper specifies, where appropriate, the kinds of organizations included in the data cited

The focus of the analysis this paper is, of course on small- and medium-sized organizations (SMOs), defined as organizations with less than 500 paid staff, within this broader universe of organizations.

³ See Policy Research Initiative (PRI), *What We Need to Know about the Social Economy* (2005).

Canadians contribute over 2.2 billion hours annually with charitable and nonprofit organizations, and the majority of these hours are spent with small- and medium-sized organizations. Almost 60% of the labour hours recorded by SMOs come from volunteers. Volunteers continue to represent a larger resource to the charitable and nonprofit sector than monetary and in-kind donations from households. In 2000, households donated \$6.5 billion to nonprofit organizations, less than half the estimated value of volunteer contributions of time. The average SMO benefits from about 14,000 hours of volunteer work per year.⁴

Size and distribution

Both SMEs and SMOs in Canada are characterized by the vastness and diversity of their sectors, the predominance of smaller organizations, and the significance of their contribution in all areas of society and the economy.

There are more than 1.5 million SMEs in Canada.

The vast majority of SMEs are small – 98% have less than 100 employees and 80% are either self-employed businesses or micro organizations (1-4 employees).

SMEs are active in all sectors of the Canadian economy, with two-thirds in the service sector (64%), one-fifth in the goods-producing sector (21%), and a significant number (15%) in the resource-based sector. SMEs in the manufacturing and primary industries tend to have larger numbers of employees, while agricultural firms and those in the service sector have a higher proportion of self-employed and micro businesses.⁵

SMOs in Canada are also characterized by the predominance of smaller organizations. There are some 160,000 registered charitable and nonprofit organizations in Canada. 98% of these

Small, vast and diverse

The very great majority of both SMEs and SMOs in Canada are small organizations

98% of both SMEs and SMOs have less than 100 employees. About one-half of all organizations have no employees (54% of SMOs and 44% of SMEs)

The SME and SMO sectors in Canada are vast and diverse.

There are 1.5 million SMEs in Canada and some 160,000 registered charities and nonprofit organizations. There are many more tens of thousands of community organizations that are not registered or incorporated

Almost two-thirds of SMEs are in the service sector, and one-fifth are in the goods-producing sector

More than half of SMOs operate in the sports and recreation, religion, and social services sectors. Larger organizations are predominantly in the health and education sectors.

⁴ National Survey on Nonprofit and Voluntary Organizations. 2003. See *A Profile of Small and Medium-sized Nonprofit and Voluntary Organizations in Canada*.

⁵ See M. Ayyagari, T. Beck, & A. Demirguc-Kunt, *Small and Medium Enterprises across the Globe: A New Database*. World Bank: World Bank Policy Research Working Paper Series #3127 (2003); *Small and Medium-sized Enterprise Financing in Canada 2003*, Industry Canada, Statistics Canada and Finance Canada; *Key Small Business Statistics*, Industry Canada July 2005; Diane Guillemette, *Small and Medium-sized Enterprise Outlook* August 2004. National Research Council of Canada (NRC) publication no. 47566; and *Key Small Business Financing Statistics-August 2005*, Industry Canada, Statistics Canada and Finance Canada.

organizations have fewer than 100 employees; 54% have no employees (44% of SMEs). More than one-half of SMOs operate in three activity areas, with 21% in sports and recreation, 19% in religion, and 12% in social services. Larger nonprofit organizations, on the other hand, are not as prevalent in these areas, and are predominantly health organizations, hospitals, universities and colleges.⁶

The distribution of both SMEs and SMOs across Canada is proportional to the overall population.

It should be noted that the above data may significantly underestimate the actual number of SMEs and SMOs in Canada. The data includes only registered businesses or incorporated organizations. With regard to SMOs, for example, there are hundreds of thousands more community and volunteer organizations that are not incorporated.

Contribution to the economy

Both SMEs and SMOs make significant contributions to the economy.

SMEs generate 43% of Canada's private-sector GDP (OECD 2000), employ 62% of Canadians working in the private sector, and have been a key source of job growth in Canada, responsible for some 80% of net employment growth in the 1990s.⁷

The nonprofit sector, including SMOs, also makes a very important economic contribution.

When the value of volunteer work is included, the overall nonprofit and voluntary sector generates almost 9% of Canadian GDP (1997), eleven times more than the motor vehicle manufacturing industry, four times more than the agricultural sector, and twice the value of the mining, oil and gas extraction industry. The sector employs over 2 million persons – the third largest employer in Canada behind manufacturing and trade. Volunteers are a critical component of nonprofit organizations' economic activity, contributing almost 20% of the total value of the sector's GDP (1997).

It is estimated that SMOs account for almost 70% (\$77 billion) of the reported revenues (\$112 billion) for the nonprofit sector in Canada, and employ some 1 million paid staff.⁸

Small . . . but powerful

Both SMEs and SMOs make a very significant contribution to the economy and employment in Canada

SMEs generate 43% of Canada's private GDP and employ 62% of workers in the private sector

SMOs generate almost \$80 billion in revenues and employ more than 1 million people.

⁶ *National Survey of Nonprofit and Voluntary Organizations (NSVO) 2003 and 2004*. See also M. H. Hall, M.L. de Witt, D. Lasby, D. McIver, T. Evans, C. Johnson, *et al.*, *Cornerstones of community: Highlights of the National Survey of Nonprofit and Voluntary Organizations*, 2003, revised, Catalogue no. 61-533.ed., Statistics Canada, Ottawa.

⁷ *Key Small Business Statistics* and RBC Financial Group, Canadian Manufacturers and Exporters and Queen's School of Business, *Managing for Growth: Enabling sustainable success in Canadian SMEs*, 2003.

⁸ Hall, de Witt *et al.*, and M. Hamdad, S. Joyal & C. Van Rompaey, *Satellite Account of Nonprofit Institutions and Volunteering*, Statistics Canada, Ottawa, 2004.

Volatility

Both SMEs and SMOs experience a significant amount of “churning” each year, as new organizations start up and others disappear.

While about 75% of SMEs in Canada have been in business for five years or more, failure rates are relatively high in the first few years after start-up with 2 out of 5 firms not surviving beyond their second year of operation.

Over the 1990s, new SMEs averaged approximately 8,800 annually, on a net basis.⁹ Almost one-half of SMOs have been in operation for less than 20 years; 87% have been in operation five years or more. Each year, approximately 4,400 charities (5.9%) experience churning (start or stop), with smaller organizations (fewer than five employee) being responsible for the majority of new starts or stops; when organizations undergoing expansion or contraction are added to this, a total of over 10,000 charities are in transition each year.¹⁰

While the late 1990s were a period of expansion for charities in Canada, the rate of expansion appears to be slowing since then, with fewer organizations reporting growing to a larger segment and more organizations reporting contracting to a smaller one.¹¹

Further data and analysis on growth and churning among SMOs can be found in the supporting paper prepared as part of this research study.

⁹ *Key Small Business Financing Statistics; Key Small Business Statistics*; Organization for Economic Co-operation and Development (OECD, *Promoting Entrepreneurship and Innovative SMEs in a Global Economy*, 2nd OECD Conference of Ministers responsible for Small and Medium-sized Enterprises (SMEs), Istanbul, June 2004; and J. Baldwin, L. Brian, & R. Dupuy, *Failure Rates for New Canadian Firms: New Perspectives on Entry and Exit*, Statistics Canada 2000.

¹⁰ NSNVO and Canada Revenue Agency (CRA) T3010 *Registered Charity Information Returns*.

¹¹ *CRA Registered Charity Information Returns*.

Financing

SMEs and SMOs use a variety of financing sources, although SMEs have access to a much greater diversity of sources, notably commercial lenders and private investors.

SMEs use a combination of formal (commercial) and informal (private investors) financing, with financing patterns varying according to firm size and nature and the stage of the lifecycle. Debt financing is the primary source of financing for SMEs, with debt accounting for 75% of their long-term financing structure.

Smaller and start-up firms, as well as self-employed and knowledge-based firms, make greater use of more informal financing sources, including owner savings and retained earnings. Larger firms and resource-based and goods-producing firms use more formal financing.

Overall, use of government financing is less important for SMEs than other types of financing. Larger firms, as well as agricultural firms, make greater use of government financing, and some regions also make greater use of government financing than others (e.g. over 7% of firms in Alberta and the Atlantic request government grants or subsidies, 1.9% of firms in Ontario).¹²

SMOs receive 40% of their revenue from earned income, 39% from government sources (16% of which is payments for goods and services and 23% is in the form of grants), 17% from gifts and donations, and 4% from other sources.

There are important differences between SMOs and large nonprofit organizations in terms of financing patterns and usage.

SMOs tend to rely more on earned income than large organizations. Revenues are highly concentrated; large organizations represent just 0.4% of all organizations but receive 31% of revenues. Large organizations are more likely to report growing revenues, while SMOs are more likely to report stable revenues. Registered charities with less than 100 employees accounted for

Financing sources and patterns

SMEs have access to a greater variety of financial sources, both formal or commercial and informal, than SMOs do

Debt financing is the primary source (75%) of long-term financing for SMEs

Use of government financing is less important for SMEs than other sources of financing

SMOs have very limited access to commercial sources of financing and rely mainly on earned income (40% of their revenues) and on government sources (39%), including payments for goods and services as well as grants; about 17% of SMOs' revenues comes from donations and gifts

Smaller and start-up organizations, among both SMEs and SMOs, tend to rely more on earned income than do larger organizations

Larger firms and organizations make more use of government funding than do smaller firms and SMOs

Financing is highly concentrated among community organizations: large organizations are only .4% of all organizations but receive 31% of revenues.

¹² Key Small Business Financing Statistics; Small and Medium-sized Enterprise Financing in Canada.

a smaller share of total revenues in 2002 than they did in 1998. As with SMEs, large organizations make greater use of government funding.¹³

Summary - Key characteristics of SMEs and SMOs in Canada

Both the SME and SMO sectors in Canada are vast, diverse, and dominated by smaller organizations – 98% of both SMEs and SMOs have less than 100 employees

Key distinctions between the two sectors are the for-profit nature of SMEs and the nonprofit mission of SMOs, and the importance of volunteers among SMOs

Both sectors contribute significantly to the economy and create jobs for Canadians

SMEs employ over 60% of private-sector workers. The charitable and nonprofit sector is the third-largest employer in Canada, after manufacturing and trade. SMOs alone employ more than 1 million people

Both SMEs and SMOs experience significant “churning”, with the frequent birth, growth and disappearance of organizations

Size matters . . . smaller organizations, for example, in both sectors are more dependent on earned income and make less use of government funding. Larger community organizations receive a disproportionate share of revenues in the sector. SMOs make greater use of volunteers than paid staff, compared to larger organizations

SMEs have greater access to a variety of financing sources. SMOs have limited access to commercial sources and rely more on earned income and government sources.

¹³ NSNVO; Hamdal *et al*; CRA *Registered Charity Information Returns*.

SMEs and SMOs in Canada – Success Factors

“Success” may have different meanings for SMEs, and SMOs, given the fundamentally different and distinguishing nature of their respective missions.

For SMEs, as business endeavours, success is usually defined in terms of growth - in sales, profits, firm size, and market share.

It should be noted however that not all SMEs consider growth to be their key or only objective.

Stability of income and employment are other important objectives. For many SME owners, lifestyle or product/service and quality are also important.

Many small and micro-businesses may be content with an adequate income and not focussed on growth and expansion, particularly if the owner has launched the enterprise for reasons such as independence, quality-of-life, or other personal factors.¹⁴

SMOs usually define success in nonprofit/non-market terms, although they do provide goods and services and fill a demand that others do not.

Success for SMOs is seen as the ability of an organization to deliver on its mission and to fulfil effectively its roles within the community it serves, and is measured in terms of results achieved for communities and individuals.

Growth, defined in terms of size or revenues or profits, is not as relevant for SMOs as it is for SMES, given their different mission.

SMOs see themselves as serving the community and responding to a need, and their goals are not necessarily to increase in size or revenues other than to the extent that helps them meet their purpose. SMOs also tend to be responsive, expanding or shrinking with the scope and severity of the issue or need they are addressing. External factors such as availability of funding are also important. If a government or donor is seized with the importance of an issue and moves to fund solutions, then organizations in this field with knowledge and expertise will grow rapidly as resources become available for them to “move to scale”.

“Success”

Success is usually measured in market terms for SMEs

For SMOs, success relates to fulfilling their mission in the community

For both SMEs and SMOs, success factors vary across the lifecycle and stage of development of the organization and include:

- management skills and competencies
- entrepreneurial skills
- quality of human resources
- access to appropriate and adequate financing
- innovation capacity
- access to and use of technology
- networking and partnerships
- government frameworks and policies

¹⁴ *Managing for Growth.*

One form of “growth” for SMOs can be seen as expanding and "exporting" good ideas and successful innovations to other communities and regions. However, this is often difficult for a number of reasons (isolation, lack of resources, difficulty to transplant successes to other very different situations), as discussed below.

Success, however defined, for both SMEs and SMOs is dependent on a number of critical factors. While there are many similarities for SMEs and SMOs in terms of these success factors, there are important differences as well, given their different missions and nature.

Success factors include both **external** factors, such as the socio-economic environment and overall government policies, and **internal** factors such as management, human resources, and financing.

These factors vary across the **lifecycle** of organizations. Whether business enterprises or charitable endeavours, organizations face different challenges at different stages of their development.

The literature on SMEs identifies a number of different approaches to defining and understanding the lifecycle of firms, as discussed in the background Profile of SMEs in Canada. SMEs’ lifecycle is usually described in terms of growth phases, from nascent/pre-start-up through start-up, early growth, expansion and sustainability or maturity.¹⁵

For SMOs, given their different mission and orientation with regard to growth, comparable development stages in the lifecycle have been labelled “imagine and inspire”, “found and frame”, “ground and grow”, etc.¹⁶ The background Profile of SMOs in Canada discusses different ways in which the lifecycle of SMOs is presented in the literature on community organizations.

The key success factors for SMEs and for SMOs can be grouped as follows: **management** skills and competencies; **human resources**; access to **financing**; **innovation** capacity; use of and access to **technology**; **networks** and **partnerships**; and **government policies** and **frameworks**, notably taxation and the regulatory regime. Each of these is discussed below.

The lifecycle of organizations is important

The lifecycle of businesses is usually seen in growth stages, from pre-start-up through expansion and sustainability

For community organizations, the lifecycle is seen as stages of organizational development, from conception to maturity

Needs vary at different stages of the lifecycle, in terms of financing, management competencies, and organizational structure. For example, both firms and community organizations may need to “professionalize” their management and structure as they reach a certain size and level of development.

¹⁵ Guillemette; *Managing for Growth*; C. N. Churchill and V.L. Lewis, *Growing Concerns: The Five Stages of Small Business Growth*. *Harvard Business Review*, 3: 30-50, 1983; Evangelia Papadaki and Bassima Chami, *Growth determinants of Micro-Businesses in Canada*, Small Business Policy Branch, Industry Canada. July 2002.

¹⁶ Simon J. Sharken and J.T. Donovan, *The 5 life stages of nonprofit organizations: where you are, where you’re going and what to expect when you get there*, Saint Paul, Minnesota, Amherst H. Wilder Foundation, 2001. See also R. Dart, P. Bradshaw, V. Murray & J. Wolpin, *Boards of directors in nonprofit organizations: Do they follow a life-cycle model?* *Nonprofit Management and Leadership*, 6 (4), 1996, and M. Wood, *Is governing board behaviour cyclical?* 1992.

Management is a critical success factor for both SMEs and SMOs

Management skills and competencies are key to business success for SMEs. Research in Canada and internationally suggests that business failures can be attributed in large part to management and organizational weaknesses; for example, some studies have found that almost half of bankruptcies result from these internal factors rather than external ones.¹⁷

SMEs require a wide variety of management skills. These include: vision and leadership, strategic planning, professional competencies, financial and human resources management, communications and marketing, organizational development, entrepreneurial skills, and networking and partnership skills.

The nature and importance of the various skills required vary across the lifecycle of firms, and what is appropriate or needed at one stage may not be the case at another stage. In the start-up phase, for example, key managerial competencies include the ability to develop and promote a guiding vision, intuitive and entrepreneurial skills, and marketing and communications skills. As a firm expands, there is a need to “professionalize” the organization, particularly in terms of financial and human resources management and expertise. At later stages, the ability to lead an organization while delegating day-to-day operations, to develop strategic alliances and partnerships, and to foresee new opportunities become critical.¹⁸

Many of these same management skills and competencies are important for SMOs as well.

As in the case of SMEs, these skills vary across the lifecycle of organizations. Management and leadership skills in the start-up and early stages are different from those required in later stages.

For example, SMOs like SMEs face the need to develop or access professional skills and expertise in financial, human resources, legal and other areas as an organization develops past the early stages of the lifecycle.

In addition, SMO management is often “thin” as many organizations lack middle management levels. Organizations usually have only an executive director and project managers, with the result that senior levels do not have time to focus on strategic planning or other organizational and management issues. SMOs have identified planning as their number one capacity issue, with 58% of SMOs saying that it is a problem for them.

Management in SMOs

As in the case of SMEs, management skills and competencies are critically important for SMOs in areas such as strategic planning and financial and human resources management

SMOs also face particular management challenges given the importance of the volunteer dimension to such organizations

The recruitment, training, support and retention of volunteers, and working effectively with a Board of Directors, require special management skills and abilities.

¹⁷ *Managing for Growth*; J. R. Baldwin, E. Gray, J. Johnson, J. Proctor, M. Raliquzzaman, and D. Sabourin, *Failing Concerns: Business Bankruptcy in Canada*. Ottawa. Statistics Canada Catalogue No. 61-525-WPE. 1997.

¹⁸ Guillemette; *Managing for Growth*.

SMOs also face particular management challenges due to their very nature. For example, the significance of volunteer resources in community organizations poses special challenges for SMOs. The management of issues around the recruitment, training, support, recognition and retention of volunteers, as well as volunteer burn-out, is critically important for community organizations, given that they rely heavily on volunteers to deliver their missions.

The ability to work effectively with boards of directors is an important management competency.¹⁹

Entrepreneurship is a key management attribute for both SMEs and SMOs

Some research indicates that “entrepreneurial intensity” – active risk-taking by individuals – tends to be greater among higher-growth SMEs. Their entrepreneurial nature may be one of the factors motivating individuals to launch their own enterprise in the first place.²⁰ For SMOs, the entrepreneurial spirit is often seen as integral to the role that they seek to play in communities, searching out innovative and creative ways to meet community and individual needs.

As well, community economic development organizations, co-operatives and social economy organizations demonstrate the capacity to apply entrepreneurship approaches, through the production and distribution of goods and services, to serve social and community goals.

Current thinking on entrepreneurship emphasizes the interplay between entrepreneurs and the local/regional environment and context.

While earlier theories of entrepreneurship tended to emphasize the role and personal characteristics of the individual, entrepreneurship is now understood to be multi-dimensional in nature, with the interrelationship among human, financial and social capital being critically important.

Entrepreneurship

Entrepreneurship is an important factor for high-growth SMEs, and is integral to the work of many community organizations

SMOs bring an entrepreneurial approach to the role they play in communities, seeking creative ways to address needs

The interdependence of the individual entrepreneur and the local community and its institutions and resources is key for success

SMOs, with their roots in local communities, hands-on knowledge and experience and ability to mobilize local and community resources, are well positioned to demonstrate entrepreneurship in responding to community needs.

¹⁹ See: NSVO; Sharken; Dart; Wood.

²⁰ Evangelia Papadaki and Bassima Chami, *Growth Determinants of Micro-Businesses in Canada*, Small Business Policy Branch, Industry Canada, July 17, 2002; Organization for Economic Co-operation and Development (OECD), *Small and Medium-sized Enterprises: Local Strength, Global Reach*. OECD Policy Brief. 2000.

Willingness to take risks, the drive for achievement, capacity for intuitive and creative thinking, and other characteristics of the entrepreneur are seen as interacting with the external environment and local institutions, the market or existence of need and opportunity, the availability of financial and other resources, and effective networks and partnerships.²¹ Community economic development organizations, for example, adopt a holistic approach that recognizes this interdependence among entrepreneurs, government policy and the local environment and community resources.

SMOs, rooted in local communities with hands-on knowledge and experience and extensive personal networks and the ability to mobilize local and community resources, are well positioned to demonstrate entrepreneurship in addressing and responding to community needs.

Human resources are also critical for success in SMEs and SMOs

For SMEs' success, the quality and supply of skilled labour are essential issues. Many firms are reporting a shortage of highly skilled personnel, as well as of skilled workers in many trades. Demographic trends will likely mean further shortages of skilled workers as well as of managers. Staff training and development are important needs, but Canadian firms tend to offer less training for employees than firms in other countries.

Human resources challenges are important for SMOs as well, and they also face particular challenges given their nature and context.

Charitable and nonprofit organizations face additional human resources challenges due to their nature and dependence on volunteers.

SMOs identify recruiting the “right” staff, and training and retaining staff, as significant challenges, as well as finding staff with professional and specialized skills. Lower compensation levels in the nonprofit sector contribute to these difficulties. Challenges relating to paid staff are, however, more common among large organizations than among SMOs. This is not surprising given that large organizations are more reliant on paid staff (94% of total hours worked for large organizations are from paid staff, compared to 41% for all SMOs).²²

²¹ *Ibid.*; Canadian Federation of Independent Business (CFIB), *Do you have what it takes? Results of CFIB survey on entrepreneurial styles*. CFIB Research. November 2004; Edward J. Chambers and Stuart E. Shaw, *A Primer on Western Canadian Entrepreneurship*, Western Centre for Economic Research, University of Alberta. Information Bulletin No. 76. April 2004; Maryann P. Feldman, Johanna Francis and Janet Bercovitz, *Creating a Cluster while Building a Firm: Entrepreneurs and the Formation of Industrial Clusters*. *Regional Studies*, Vol. 39.1. February 2005.

²² See: NSVO; Hall, de Witt *et al*; R. Saunders, *Passion and Commitment under stress: Human resource issues in Canada's nonprofit sector. A synthesis report*, Canadian Policy Research Networks (CPRN), Ottawa, 2004; M. H. Hall, A. Andrukow, C. W. B. Brock, M. de Witt, *et al*, *The capacity to serve: A qualitative study of the challenges facing Canada's nonprofit and voluntary organizations*, Canadian Centre for Philanthropy, Toronto, 2003; L. J. Roberts, *Caught in the middle: What small, nonprofit organizations need to survive and flourish*, Voluntary Sector Initiative (VSI), Ottawa, 2001.

Many SMOs report human resources challenges relating to recruiting, training and keeping **volunteers**. Issues and needs identified include: need for more volunteers, especially given growing government demand for nonprofit organizations to deliver important public services; need for long-term commitments from volunteers; need for volunteer leaders; declining availability of volunteers; need for volunteer training and development; and need for organizations to develop sophisticated systems to manage and administer volunteer programs. The majority of SMOs also report significant challenges in obtaining Board members.²³

Access to adequate and appropriate financing is an essential success factor for both SMEs and SMOs

While financing is critical for both SMEs and SMOs, the financing challenges they face are, for the most part, quite different.

Financing is often identified by SMOs as an important challenge facing organizations, and is seen as being closely related to other capacity issues such as staff recruitment and retention.²⁴

Given the nonprofit nature of their mission and their greater dependence on government and public funds, SMOs face particular kinds of challenges relating to public funding in addition to financing challenges more generally.

Although important, financing issues seem to be somewhat less critical for SMEs, who tend to identify external factors such as the market/competition, taxation and government policies as key challenges, as well as management issues.

At the same time, and while generally having better access than SMOs to external financing sources, SMEs do experience a number of important financing gaps and barriers.

Financing challenges

Smaller and start-up organizations, among both SMEs and SMOs, have difficulty accessing external financing, frequently due to a lack of assets or credit history

As well, given their mission, SMOs are often unable to demonstrate return-on-investment in financial or market terms

“Informational asymmetries” due to lack of communications skills for dealing with investors or lack of appropriate financial tools and systems can exacerbate these difficulties for both SMEs and SMOs

SMOs generally have much less access to commercial financing than SMEs

SMOs are more dependent on government/public financing and face significant challenges with regard to that funding

- over-reliance on project funding, due to a shift in funders' approach
- lack of stability (one-year contracts)
- under-funding of operational costs for delivery of government services
- increased accounting requirements, red tape and paper burden

²³ *Ibid.*

²⁴ *Ibid.*

Smaller SMEs and start-up SMEs, in particular, experience difficulties in accessing formal and commercial sources of financing.

These kinds of firms typically have smaller profits and uncertain return-on-investment, fewer assets or collateral, and may lack credit history and “track-record.”

Higher-growth SMEs and SMEs in knowledge-based industries may have similar difficulties accessing commercial financing since they may lack tangible assets or may require an incubation period for their products or services before showing results.

An adequate supply of risk capital is a further problem for SMEs in Canada.²⁵

SMOs face significant challenges with regard to both *financing* – access to private and commercial revenue sources – and *funding* – grants and contributions from government/public sources for goods and services provided.

Smaller and start-up SMOs face similar financing difficulties as those experienced by smaller and start-up SMEs, and often for very similar reasons, i.e. lack of credit history or assets.

As well, given their mission, SMOs are unable to project profits and return-on-investment in financial terms. Banks and other financial institutions may also be reluctant to provide financing for SMOs because they do not wish to face the public relations risk of foreclosing on defaulted loans for activities responding to a community or social need (e.g. shutting down a women’s shelter).

Some of the difficulties in accessing financing that are experienced by both SMEs and SMOs may be due to “informational asymmetries” and management and organizational capacity issues.

Owners or managers may lack communications skills (talking “the language of finance”) and other skills or appropriate tools (e.g. financial systems) to deal successfully with potential investors. A “knowledge gap” may exist where investors may not adequately understand small and medium-sized enterprises or the work of nonprofit and charitable organizations, and SME and SMO management may be unable to communicate effectively information about their products and services in ways that inform and interest investors.²⁶

SMOs also identify significant challenges with regard to funding obtained through subsidies and grants and contributions from government and other sources such as foundations.²⁷

Organizations report an over-reliance on project funding, in large part as a result of a shift in funders’ approach away from “core” or operating financing to project-based funding. Such funding is often not reliable, as contracts are usually for only one year at a time.

²⁵ Equinox Management Consultants Ltd., *Gaps in SME Financing: An Analytical Framework*. Industry Canada. February 2002; *Key Small Business Financing Statistics*; *Small and Medium-sized Enterprise Financing in Canada*; *Promoting Entrepreneurship and Innovative SMEs in a Global Economy*.

²⁶ *Gaps in SME Financing*; Guillemette; *Promoting Entrepreneurship and Innovative SMEs in a Global Economy*.

²⁷ See Katherine Scott, *Funding Matters: The Impact of Canada’s New Funding Regime on Nonprofit and Voluntary Organizations*, Canadian Council on Social Development, Ottawa, 2003; *The Capacity to Serve*; NSNVO; Roberts.

Moreover, government and other funders often do not include adequate funding for the operational, administrative and overhead costs of projects and service-delivery, leaving organizations to absorb or finance these from other sources, further reducing their financial capability and flexibility.

Organizations also need to invest important resources in “chasing” project funding, often in competition with other organizations.

Increased government administrative, **accountability** and reporting requirements, with ever-greater paperwork burden and lengthy delays in approvals/payments, are an important and growing issue for nonprofit organizations, requiring significant resources, time and effort. Along with the change to year-by-year project-based funding and the loss of core funding, they are seen as putting some organizations’ very survival at risk as well as compromising their ability to innovate and to respond to the needs of their communities.²⁸

Innovation capacity is a significant success factor for both SMEs and SMOs

While there are some important differences in how they approach and undertake innovation, many of the same factors apply for SMEs and SMOs in achieving successful innovation.

A recent Government of Canada White Paper (2001) defines innovation as “the creative process of applying knowledge and the outcome of that process.”²⁹

For both SMEs and SMOs, innovation is increasingly seen in the broadest possible terms, not limited to new products and services but including the improvement of existing ones as well as better processes and ways of delivering goods and services.

Some research suggests that a firm’s innovation capacity is the single most important determinant for SMEs’ growth and success.³⁰

Innovation capacity in SMEs is usually measured in terms of proxies such as Research and Development (R&D) expenditures, R&D-to-sales ratio, or the number of new or significantly improved products, goods or services introduced over time. SMEs in Canada spend much less on R&D than larger firms, but as a percentage of revenue R&D spending by SMEs is much greater.³¹

Our understanding of the innovation process for SMEs emphasizes the interplay of several factors in fostering and sustaining innovation, rather than the predominance of any one single factor.

²⁸ *Ibid.*

²⁹ Government of Canada, *Achieving Excellence: Investing in People, Knowledge and Opportunity*, 2001.

³⁰ John R. Baldwin, *Innovation: The Key to Success in Small Firms*. Statistics Canada catalogue no. 76. February 1995; Zoltan Acs, Randall K. Morck, and Bernard Yeung, *Small Firms, Globalization, and Canadian Public Policy*. Joint Series of Competitiveness No. 20. January 2000; Papadaki and Chami; *Promoting Entrepreneurship and Innovative SMEs in a Global Economy; Managing for Growth*.

³¹ Papadaki and Chami.

Key innovation factors include:

- R&D;
- the role of the individual entrepreneur;
- the market, in-depth knowledge of it, and both the presence of new opportunities and the ability to see and take advantage of them;
- the local environment, resources and supports;
- management competencies and skilled human resources;
- organizational flexibility and adaptability;
- the use of/access to technology;
- the capacity of a firm for networking and partnerships, including the advantages offered by geographically-concentrated clusters of related, specialized firms.³²

The small size of SMEs may also be a contributing factor to innovation success.

SMEs have fewer resources than larger firms and rely more on local networks for inputs to innovation. They may therefore tend to look for innovations in “less crowded” areas of activity/research and be able to see and respond to opportunities unnoticed by larger firms. SMEs’ greater organizational flexibility is an advantage over larger firms who may become “wedded” to existing products and practices. There is some research evidence to suggest that truly “radical” innovations come more from smaller firms.³³

For many SMOs, innovation is their very *raison d’être* - finding creative solutions to address community and individual needs.

Social innovation is innovation in tackling social and community problems. It is about applying the best ideas and creative solutions to societal issues, using new thinking, organizational creativity and institutional adaptation, engaging citizens and mobilizing community and other resources.

SMOs are well placed to play a leading role in social innovation in Canada.

Nonprofit organizations can go where the state cannot go or the private sector chooses not to go. They have the ability to work horizontally and holistically across programmatic, sectoral and jurisdictional barriers and use their extensive local knowledge, networks and organizational flexibility to develop and implement creative, place- and community-based solutions.

R&D expenditures may not be as relevant for SMOs’ innovation capacity as they are for SMEs; the “laboratory” for innovation that is used by SMOs is the community itself.

³² Maryann P. Feldman, Johanna Francis and Janet Bercovitz, *Creating a Cluster while Building a Firm: Entrepreneurs and the Formation of Industrial Clusters*. Regional Studies, Vol. 39.1. February 2005; Organization for Economic Co-operation and Development (OECD), *Networks, Partnerships, Clusters and Intellectual Property Rights: Opportunities and Challenges for Innovative SMEs in a Global Economy*, Background information for the 2nd OECD Conference of Ministers responsible for Small and Medium Enterprises, Istanbul, Turkey. 2004.

³³ *Globalization, and Canadian Public Policy*.

Innovation in SMEs and SMOs

Innovation is increasingly understood to apply to both SMEs and SMOs in the broadest sense – including both new and improved products, services and processes

For SMEs, innovation is seen as the single most important factor for growth and success, and is usually measured in market terms (R&D, etc.)

For SMOs, innovation is what they are all about – finding creative solutions to community and individual needs

Key factors for innovation in both SMEs and SMOs include size and flexibility, management and entrepreneurial skills, networking and partnership and interaction with the local environment

SMOs possess many of the key attributes understood to be critical for innovation – tacit knowledge and hands-on experience, social and interpersonal interaction and learning, strong local networks

A critical challenge for SMEs is the ability to commercialize innovations

For SMOs, a key issue is how to “export” successful community innovations and creative solutions.

However, many of the factors noted above regarding SMEs and innovation also apply to innovation in/by SMOs – management skills and entrepreneurial spirit; human resources, and, in the case of SMOs, vast volunteer resources; interaction with the local environment, resources and supports; their smaller size and organizational flexibility and adaptability; and networking and partnerships.

SMOS also possess many of the key attributes that research suggests are essential for innovation.³⁴

Current thinking on innovation emphasizes the importance of different kinds of knowledge, including “*know-how*” or the skills to carry out certain actions, and “*know-who*” or knowing who knows what to do and how to do it. “Tacit” knowledge, derived from experience and mutual learning, is considered as important as “codified” knowledge.

The social and interpersonal aspects of innovation are also increasingly understood to be important to the innovation process; “dialogue innovation” is innovation that happens when people interact and that interaction creates new dimensions of performance. People are the “creators and carriers” of knowledge.³⁵

³⁴ J. Maxwell, *Innovation is a social process*, Statistics Canada, Ottawa, 2003; J. Ruvinsky, *Beware the lone genius: Innovation depends on social networks, not solo brains*, Stanford Social Innovation Review, 2005.

³⁵ *Ibid.*

SMOs are especially able to bring together these different kinds of knowledge, networking and social capital to foster innovation at the community level.

The Peter Drucker Canadian Foundation has studied hundreds of examples of innovation by Canadian nonprofit organizations, and identified six key criteria for successful innovation.³⁶

These innovation success factors are: the extent to which an organization has had to adapt innovative practice in order to make programs happen; the impact of activities on an organization's work; outcomes that express the impact of programs and help to improve the organization's work; sustainability of programs; replicability of programs in other organizations; and partnership-building, either between organizations in the sector, or across sectors, such as nonprofit/private partnerships and nonprofit/government partnerships.

A key innovation challenge for SMEs is being able to "commercialize" innovations and bring them to the market. For SMOs, the parallel challenge is the ability to "export" community-based innovations to other sectors and areas of activity and to other communities and regions.

For both SMEs and SMOs, access to financing for innovation purposes may pose problems.

SMEs experience difficulty in obtaining risk capital and private financing for investments in R&D and new technologies; such investments may be seen as too risky or not offering immediate returns. SMOs face similar challenges, compounded by the generally more non-market nature of their mission and return-on-investment.

A number of government programs and initiatives have been put in place to help meet these financing challenges for SMEs, as described in the background Profile of SMEs in Canada.

For SMOs, government funding for innovation purposes can sometimes be seen as a two-edged sword; organizations are concerned that seeking out and obtaining project- or special-purpose funding may drain already scarce resources and further deflect them from their core mission and mandate, for which funding is already inadequate.

As with firm clusters in the case of SMEs, there is some evidence that the development of "innovation clusters" may be effective in facilitating social innovation in and by SMOs.

The Center for Social Innovation in Toronto is one such cluster, designed as a community hub for social innovation and providing semi-shared office space and resources for a number of small organizations from a variety of activity areas including arts and culture, environment and advocacy.

Community economic development organizations also often pursue a model of development that takes advantage of clustering possibilities.

³⁶ www.innovation-award.ca/.

Technology is important

Access to and use of information and communication technologies (ICT) can be important for the development and growth of SMEs and is closely linked to innovation capacity.

Smaller enterprises, however, tend to adopt basic information technologies because they are relatively inexpensive and easy to acquire and implement. Smaller firms lag behind larger ones in the use of more complex technologies such as websites, intranets, and e-commerce.

Common barriers for SMEs to adopt more advanced technologies include acquisition and maintenance costs, availability of skills and qualified personnel, transaction security and trust factors, and concerns about intellectual property rights.³⁷

SMEs and community organizations generally lag behind the public and private sectors in using information technology.

Factors in this include: the diversity of the sector, e.g. the differing needs of rural and smaller SMEs as opposed to larger organizations; limited technology knowledge and expertise on the part of staff, board members and volunteers, with the result that relatively few organizations are able to effectively use technology strategically to accomplish their mission; limited access to funding for technology acquisition and development, and restrictions by funders on using funds for core operations and costs, including information technology; and limited means of communication and networking for organizations.³⁸

Some small organizations report a need for access to basic technological infrastructure services such as computers, phones, fax machines, and photocopiers. Other issues include the need to maintain equipment, acquire appropriate software, and train staff. Organizations in rural and remote areas generally lack communications infrastructure such as high-speed Internet access.

In addition to the core needs of hardware and software as well as maintenance and networking, some sector organizations express the need for applications such as on-line tools for grantmakers and grantseekers, a “common footprint” for funding applications, a national network of technology trainers, and awareness campaigns about availability of tools and discount warehousing to facilitate acquisition.

The challenge of technology

SMEs lag behind larger businesses in exploiting technology

And SMOs lag behind the private and public sectors

SMEs and SMOs face similar challenges in the acquisition and use of new technologies

Smaller firms and organizations tend to use more basic technologies

Factors include costs, lack of knowledge and information, skills and expertise.

³⁷ Guillemette; *Promoting Entrepreneurship and Innovative SMEs in a Global Economy*.

³⁸ Roberts; see also *Voluntary Sector Initiative (VSI)*, Ottawa, 2001, 2002, 2005.

The VolNet program and the IM/IT component of the Voluntary Sector Initiative (VSI) provided some strengthening of technology and technological resources within the nonprofit sector. The VolNet program, which was delivered through a series of “hub” organizations, is cited as a model for sector capacity-building in technology as well as in other domains.

The ability to develop effective networks and partnerships is increasingly recognized as an important success factor for both SMEs and SMOs

Networks and partnerships are essential for firms and organizations in order to access external sources of information, knowledge, expertise and technology, anticipate and take advantage of strategic opportunities, and mobilize available resources. As already noted, they are important factors for fostering innovation.³⁹

SMEs in Canada benefit from a wide range of organizational and institutional supports and structures.

Organizations such as local and national Chambers of Commerce, the Canadian Federation of Independent Businesses (CFIB), Boards of Trade, and so on, as well as sectoral organizations and associations, facilitate the exchange of knowledge and expertise, promote collaboration among firms for common purposes, conduct research and studies, and speak on behalf of members.

Infrastructure networks are much thinner and occasional in the community organization sector than in the SME world.

There are, of course, a number of organizations that operate across Canada with a series of branches and affiliates. For example, the YMCA, the United Way, the Boys and Girls Clubs, the Canadian Cancer Society, and so on all have a organizational members in different locations.

A second type of network is coalitions across sub-sectors. Some of these are groupings under umbrella organizations, e.g. the Canadian Conference of the Arts, the Canadian Parks and Recreation Association, the Canadian Council for International Cooperation or the Canadian Association of Youth-Serving Agencies. Others are purpose-built coalitions, e.g. the Canadian Environmental Network of small environmental organizations across Canada, or the Canadian Health Charities Council. While these exist in a number of sub-sectors, other sub-sectors do not have a recognized on-going overall umbrella organization or coalition.

A third category are umbrella organizations which address large horizontal areas of sector activities, e.g. volunteerism, philanthropy or policy action. Organizations such as Imagine Canada, Volunteer Canada, Philanthropic Foundations Canada and Community Foundations Canada fall within this category.

³⁹ *Managing for Growth; Promoting Entrepreneurship and Innovative SMEs in a Global Economy; Networks, Partnerships, Clusters and Intellectual Property Rights: Opportunities and Challenges for Innovative SMEs in a Global Economy; Creating a Cluster while Building a Firm: Entrepreneurs and the Formation of Industrial Clusters.*

Additionally, the last few years have seen the beginnings of some geographic cross-sectoral coalitions or networks at the city level, and a few at a regional or provincial level. Networks such as the Calgary Chamber of Charities or the British Columbia Voluntary Organizations Coalition are deliberately cross-sector and provide opportunities for collaboration and collective action.

However, these kinds of networks and organizations are for the most part few and far between in the SMO world, and most are still fledgling.

Many SMOS continue to operate alone, a situation that hinders their ability to work horizontally and that is conducive to inefficiencies as many organizations with few or no staff attempt to perform the full range of “back office” functions as well as carry on their mission.

Key informant interviews confirmed SMOs’ sense of isolation.

“It’s the loneliest job in the world, running a small nonprofit”, noted one person. “There’s a real thirst to connect and network.”

External factors and Government policies and frameworks are important as well

Both SMEs and SMOs identify external factors and government policies and frameworks as important factors influencing success.

External factors include the economic context, both locally/nationally and internationally, markets, and the demand for their products and services. SMEs, and businesses in Canada generally, frequently identify the general economic climate as their number one concern.

Government policies such as **taxation** and **regulatory** frameworks can assist or impede both business firms and nonprofit organizations in their development. Taxation policies, notably capital gains taxation and payroll taxes (e.g. employment insurance), and levels of taxation are rated highly by SMEs as important concerns, with businesses feeling that current policies act as a deterrent or “brake” on entrepreneurship and investment.⁴⁰

The regulatory regime in Canada is seen by SMEs as too complex, onerous, and costly. Regulatory issues are especially problematic for smaller businesses, as they may mean proportionately higher costs for them than for larger businesses, due to economies of scale. SMEs are also critical of the multiplicity and layering of regulations by different orders of government. Growing government administrative red tape and reporting requirements have sparked demands for “smarter” regulations, not “more.”⁴¹

Nonprofit organizations are exempt from income tax and donations to registered charities are tax-deductible. However, only about one-half (56%) of SMOs have charitable status, with the remainder unable to access foundation funding or give charitable receipts for donations.

⁴⁰ RBC Financial Group, Canadian Federation of Independent Business (CFIB) and Canadian Manufacturers and Exporters, *The Path to Prosperity: Canada’s small- and medium-sized enterprises*. October 2002; *Managing for Growth*.

⁴¹ *Ibid*; Industry Canada, *Small Business and Regulatory Burden*, Small Business Policy Branch. 2003.

As well, existing limitations under the Income Tax Act on the disbursement of charities' funds⁴² make it difficult for them to invest in capacity-building.

The current regulations in the Income Tax Act also significantly restrict the ability of charitable organizations to engage in activities relating to public policy development, and often force them into "reactive" mode, rather than being proactive. The current wording of the Act on limitations on "political" activity is problematic for many charities, as such organizations want and need to be involved in public policy development but the lines between advocacy, education, policy development and political activity can be unclear.⁴³

Affordable, accessible and stable liability insurance has been identified as an important need of nonprofit and voluntary organizations. Liability insurance is not affordable for many organizations, while others cannot access it at all, and policy changes, coverage cutbacks and rising prices pose serious problems.

The nonprofit sector has long asked for changes to the regulatory regime in these and other areas, and a number of specific recommendations were put forward under the *Voluntary Sector Initiative (VSI)*.

Government **procurement** is considered an important issue for both SMEs and SMOs, as they experience difficulties accessing and competing for government business. Problems include lack of information and knowledge about possibilities and processes, cumbersome procedures and red tape, and the limited resources in smaller firms/organizations.

Further information and analysis on the success factors for SMEs and SMOs can be found in the supporting papers prepared as part of this research study.

⁴² The disbursement quota is a specific amount that a registered charity must spend each year on charitable activities or as gifts to qualified donors. A disbursement excess is created when a charity spends more on charitable activities or gifts than is required by its disbursement quota for that year. An excess can be carried back one year to offset a shortfall, or a charity can draw on its excess for up to five following years to help it meet its disbursement quota. A disbursement shortfall is created when a charity spends less on charitable activities or gifts than its quota for a given year. The charity must draw on its previous years' excesses to cover a shortfall or try to spend enough the following year to create an excess to make up for the shortfall. Continuous shortfalls can lead to revocation of the charity's registration. See <http://www.cra-arc.gc.ca/tax/charities/policy/csp/csp-d14-e.html>

⁴³ The *Voluntary Sector Initiative* recommended specific changes to the wording of the Income Tax Act to allow charitable organizations more freedom to engage in advocacy work and contribute to policy development.

Public Policies and Supports

Government of Canada supports for SMEs include:

- Loans, loan guarantees and other financing assistance through the *Canada Small Business Financing Act*
- “One-stop shopping” at *Industry Canada’s* small business information website *Strategis* for information, tools, and links to other sources of assistance
- Information, technical advice and financing assistance through *Canada Business Service Centres* and the *Business Development Bank of Canada*
- Information support and advisory services, as well as a wide variety of programs of financing assistance, through the regional economic development agencies such as the *Atlantic Canada Opportunities Agency*, the *Canada Economic Development for Quebec Regions* and *Western Diversification*
- Financial support for innovation, R&D and technological development under programs such as the *Industrial Research Assistance Program (IRAP)* and the *Connecting Canadians* initiative
- Financial and other assistance from *Human Resources and Skills Development Canada (HRSDC)* to create jobs, help businesses with human resources needs, and support initiatives by industrial sectors and sectoral organizations to identify and address needs collectively
- Tax measures such as R&D tax credits, small business tax rate reductions, tax credits for venture capital investments, and various capital gains measures
- Assistance for SMEs in accessing the government procurement system and competing for government business, through the *Office of Small and Medium Enterprises (OSME)* under Public Works and Government Services Canada (PWGSC)
- Support for export and international markets development through *Export Development Canada*, the *Trade Commissioner Service*, and *Team Canada*

SMEs in Canada also receive support from many **Provincial and Territorial governments**.

Ontario, for example, has 50 *Small Business Enterprise Centres* across the province, *Business Advisory Services Offices*, the *Small Business Agency of Ontario*, and the *Ontario Investment Service*, as well as programs such as the *Community Small Business Investment Fund Program* and the *Labour Sponsored Investment Fund*.

Quebec provides an extensive array of programs and services, including financial assistance and tax measures, in support of businesses, regional development, exports, and science and technology. Alberta also offers a wide variety of supports.

Public policies and supports for SMEs **internationally** can be grouped into several major categories:

- Governments adopt and pursue framework policies – including legislation, taxation and regulatory regimes – to support growth, competitiveness and productivity and an overall economic environment in which small businesses can flourish

- Most governments have a department or agency responsible for SME policies and supports and for interface between SMEs and government and elected officials, e.g. the UK's *Small Business Service* and *All-Party Parliamentary Small Business Group*
- Governments provide information, consulting/advisory and referral services, tools and other non-financial supports, e.g. UK *Small Business Services* (SBS) and USA *Small Business Administration* offices and *Centres for Entrepreneurship*
- Governments provide a wide variety of financial support and assistance to SMEs and facilitate access to private financing by SMEs, e.g. UK *Small Business Investment Task Force*
- Governments have adopted a wide variety of policies and measures to foster and support innovation and technological development, e.g. UK's *Smart Scheme*, EU *Business Innovation Centres* and *Structural Funds*
- Governments undertake various measures to support infrastructure organizations and "intermediaries", such as business associations, technology assistance centres, self-help groups, etc., to foster cooperation and partnership among SMEs and provide improved access to information, financial and technological resources and new markets
- Governments adopt procurement policies and measures to provide fair access to government business, e.g. USA's *Small Business Contracts Council*, UK's *Procurement Concordat*

The effectiveness of these many different instruments depends in large measure on the particular economic, social and governmental context.

However, a number of general observations can be made in terms of lessons learned from Canadian and international experience, drawing on relevant research and studies, program evaluations, and international reports and cross-country comparisons:⁴⁴

Blanket, one-size-fits-all policies are generally less successful. Policy initiatives and supports for SMEs are more effective if they are directed towards specific issues, needs and clearly identified barriers or gaps at different stages of firms' development. For example, the OECD recommends focussing public support on early stages and leveraging private financing.

Money isn't the only answer, or necessarily the best answer. Direct government funding for SMEs, in the form of grants and subsidies or loan and loan guarantee programs, may not always be the most effective solution and can distort the market, displace private financing, and discourage private investment. Moreover, government programs often do not provide an appropriate incentive structure, and governments may lack the technological and management expertise to provide advice to firms and monitor performance.

⁴⁴ See, for example: Organization for Economic Co-operation and Development (OECD), *The Bologna Charter on SME Policies*, June, 2000; OECD, *Promoting Entrepreneurship and Innovative SMEs in a Global Economy*; OECD, *Networks, Partnerships, Clusters and Intellectual Property Rights: Opportunities and Challenges for Innovative SMEs in a Global Economy*; Papadaki and Chami; Guillemette; Industry Canada, *Evaluation of the Canada Small Business Financing Program, Final Report*. Audit and Evaluation Branch. November 2004; Industry Canada, *Evaluation of the Canada Community Investment Plan. Final Report*. Audit and Evaluation Branch. September 2001.

Government supports for SMEs should be linked to broader economic and regional development strategies. International experience indicates that SME support policies are most effective when situated within the broader economic, regional and community context, focussing available public resources on the needs of the economy at the regional (or national) level.

Direct government loan programs and loan guarantee programs must be appropriately designed. International experience suggests that such programs may displace private financing and that they generally do not share potential upside return but assume a significant portion of downside risks. They also tend to have low volumes of operations and high operating costs.

Government supports that provide or improve access to information, tools and expertise and encourage networking and partnership can be effective. Supporting SMEs' development through the provision of access to information, knowledge and technical assistance, and by supporting networking and the exchange of knowledge, expertise and information among SMEs, is seen as a legitimate and valuable role for governments.

For example, Government can assist in bringing enterprises and financing/investing parties together, and in providing financing-related tools and technical assistance to SMEs, e.g. financial accounting and reporting tools, assistance in presenting a business case, in measuring and reporting returns, and in "talking the language of finance". As noted above, research attributes at least some of the financing difficulties experienced by SMEs to "information asymmetries" between firms and financial institutions and potential investors, and lack of skills on the part of entrepreneurs in terms of relating to potential investors.

Support for the development of an "expert intermediary sector", including the formation of "angel" and other networks is seen as an effective means to bring together private investors seeking good investment opportunities and entrepreneurs searching to raise finance by providing a channel of communications.

Measures to assist SMEs to pool risk may be also appropriate and helpful – e.g. several countries (Japan, Italy, France) have measures to help local SMEs and SME associations to assist each other through mutual guarantee funds or loans among members.

Supporting innovation bears results. Policies and programs to support innovation in and by SMEs, including R&D investments and technology acquisition are seen as effective. Government support can be justified to help reduce uncertainty and risks associated with financing innovative SMEs. Privately-led insurance schemes for innovative SME loans can be another effective means. Governments can also encourage the formation of small business associations that can provide insurance (or guarantees) on bank loans to their members, thereby spreading out and sharing risk.

Access to technology is important. As noted earlier, research underlines the importance of technology as a key factor supporting innovation and the growth and development of SMEs. Government programs to assist firms in acquiring and adapting new technology can be effective and help firms to move beyond basic connectivity and foster business

environments that facilitate e-business and the use of more complex applications of technology.

Supports for SMOs

A wide variety of supports for charitable and nonprofit organizations are available from governments in Canada and internationally.

The **Government of Canada** provides substantial financial support to the sector in the form of grants and contributions from a large number of departments. In addition, financial support to charitable and nonprofit organizations is provided through taxation policy. Recent announcements have also stated the commitment of the government to support social economy organizations.

In 2001, the Government of Canada launched the *Voluntary Sector Initiative (VSI)*, a five-year joint initiative with the voluntary sector with the goals of strengthening the relationship between the sector and government, enhancing sector capacity, and improving the regulatory framework for the sector.

Seven Joint tables addressed creating a framework agreement for the voluntary sector, increasing the capacity of the sector, improving the regulatory framework, increasing public recognition of the sector and its contributions, promoting and supporting voluntarism, assessing the technology needs of the sector, and overseeing and coordinating the VSI.

The VSI initiative was also a recognition by the Government that it is, in some respects, a “client” of charitable and nonprofit organizations and enjoys a special relationship with the sector, given that, increasingly, it delivers significant public programs and services through the sector.

Financial support of the charitable and nonprofit sector by the federal government is provided for a variety of different purposes and in different forms. Funding includes: contracts with charitable and nonprofit organizations for the provision of goods and services; grants and contributions for particular purposes, notably to deliver public programs and services; and support to organizations because their mission aligns very closely with government policy objectives and purposes. Funding is also provided indirectly through transfers to provincial and territorial governments for healthcare, education and social services.

Financial support of charitable and nonprofit organizations by government is also provided through taxation policy. The *Income Tax Act* and the *Excise Act* give nonprofit organizations and charities preferential treatment. Both charities and other nonprofit organizations are exempt from income tax, and donations to registered charities are tax deductible for both individuals and corporations. Also, both charities and other registered nonprofit organizations are eligible for sales tax rebates. Tax exemptions support charities by creating incentives to individuals to donate to registered charities and deemed charities.

In recent budgets, as noted earlier, the Government of Canada announced its intention to provide additional supports to social economy organizations, including giving them access to programming supports for SMEs.

Significant support is also provided to charitable and nonprofit organizations in Canada by the **provincial and territorial governments**. 90% of nonprofit organizations incorporate at the provincial/territorial level.

Provincial/territorial supports take seven general forms:

- the development of policy frameworks to guide sector-government relations, and policies for funding nonprofit organizations, for example Quebec's *community action* policy and funding policies including core funding, support for operational capacity development, and funding for projects and for innovative initiatives and new services, as well as for training and professional development;
- support of volunteerism, for example Ontario's appointment of a Minister responsible for volunteerism;
- promoting direct volunteerism for government departments, as when British Columbia moved to staff its parks exclusively with volunteers;
- participation by the nonprofit and voluntary sector in consultations and policy work;
- supporting the sector in the delivery of services, such as Ontario funding of community-living organizations through transfer payments;
- funding the sector for community initiatives, as is done by the Ontario Trillium Foundation and the Alberta Wild Rose Foundation;
- addressing regulatory and legal liability issues, for example when Alberta enacted rules on fundraising meant to strengthen trust in the sector;
- support for co-operatives, economic development organizations, and social economy and social enterprise organizations.

Non-governmental supports are also available to charitable and nonprofit organizations in Canada through foundations and other grant-making bodies, corporations, and financial institutions. For example, *Varatana*, a community charity bank modeled on the UK's Charity Bank, is being established in Ontario. The *VanCity Credit Union* has a 25% market share in serving nonprofit organizations, and has a "triple bottom line" policy looking at financial, social, and environmental returns.⁴⁵

The *Canadian Directory to Foundations and Corporations* of Imagine Canada lists 2200 foundations and 140 corporations that disburse funding to organizations.

International policies and supports for the charitable and nonprofit sector

Many countries have adopted framework agreements to guide the relationships between government and the charitable and nonprofit sector, including the United Kingdom (*Compact* and *Compact Plus*), France, and New Zealand. Such agreements provide principles and guidelines for government-sector relations, codes for good practices, and provisions for on-going dialogue.

⁴⁵ F. J. Diekmann, *Targeting nonprofits. VanCity finds healthy lending market in nonprofits*, the Credit Union Journal, 2004.

Governments provide a wide variety of policies and supports for charitable and nonprofit organizations. France, for example, funds volunteer training, innovative practices, and new approaches for the development of organizations through the *Conseil du développement de la vie associative*. In both France and the UK, as in Canada, government funding makes up a significant proportion of nonprofit organizations revenues (58% and 47% respectively, including funding for health, education and social services).⁴⁶ A smaller proportion of organizations' revenues comes from government sources in the USA (30.5%), while a much broader range of financing services are available to organizations, in part as a result of government regulation and policies and tax incentives (e.g. the *Community Reinvestment Act* and the *Community Development Financial Institutions Fund*).⁴⁷

Many countries also provide public support to social economy enterprises through research and the development of various tools and instruments, regulatory frameworks, and funding for service-delivery, project-funding, capacity-building and participation in policy-making.

Further information and analysis on public supports for SMEs and SMOs, in Canada and internationally, may be found in the supporting papers prepared as part of this research study.

⁴⁶ E. Archambault, M. Gariazzo, H. K. Anheier and L.M. Salmon, *France: from Jacobin tradition to decentralization*, in L. M. Salmon, H. K. Anheier *et al* (eds), *Global civil society: dimensions of the nonprofit sector*, Baltimore, John Hopkins Centre for Civil Society Studies, 1999. M. H. Hall, C. W. Barr, M. Easwaramoorthy, S. Sokolowski & L. M. Salmon, *The Canadian nonprofit and voluntary sector in comparative perspective*, Toronto, 2005. J. Kendall & S. Almond, *United Kingdom*, in Salmon, Anheier *et al*.

⁴⁷ Solowski & Salmon. C. Strandberg, *Over the horizon: The future of Canada's capital market for social and environmental innovation*. Social Capital Market Roundtable Report. ONNOVA Learning, *Building a collaborative partnership between the Government of Saskatchewan and the Voluntary Sector: A Review of Best Practices*, Regina, Premier's Voluntary Sector Initiative.

Recommendations to Improve Supports for SMOs in Canada

This research study by Imagine Canada and Canadian Policy Research Networks (CPRN) has examined SMEs and SMOs in Canada: their contribution to Canadian society and the economy; key characteristics, similarities and differences; success factors; and public policy supports available to them.

The study underscores that SMOs, like SMEs, play an important role in Canada. They make a significant contribution to the economy, are key instruments for vibrant and sustainable communities, deliver important public services, contribute to a health democracy, and are in the vanguard of social innovation.

At the same time, SMOs face significant challenges in fulfilling their mission in Canadian society.

While the study found that there are essential differences between SMOs and SMEs, it also found that many of the same success factors are critical for both: management skills and competencies; human resources, including volunteers in the case of SMOs; access to financing; innovation capacity; use of and access to technology; networks and partnerships; and government policies and frameworks, notably taxation and the regulatory regime.

Governments in Canada and internationally began in the 1980s to undertake significant research and data/information-gathering activity with regard to SMEs and to put in place, over time, a vast array of policies and supports, recognizing their contribution to the economy and also imperfections in the market, e.g. access for such firms to private and commercial financing.

Today, governments are increasingly recognizing the vital role in the economy and society that is played by community organizations and the special nature of the government-sector relationship. Governments are working to understand organizations better, collect and analyse data/information and do research to increase knowledge about them, and put in place policies and supports to help them meet the challenges they face, including addressing market imperfections in terms of access to financing and other supports.

The recently announced intention by the Government of Canada to improve supports for social economy organizations, including giving them access to supports for SMEs, is an example of an important step forward in this regard.

The Imagine-CPRN study shows, however, that there remain considerable gaps in terms of our knowledge of SMOs and the supports available to them.

This examination of SMEs and SMOs suggests a number of areas where, drawing on experience in Canada and internationally, it is recommended that governments give consideration to providing or improving public policy supports for SMOs.

In some instances, this could be done by opening up, and adapting as required, programs and supports for SMEs in order to make them available and accessible to SMOs.

In other cases, new programs and supports, directed and tailored to SMOs, may be the best route.

The recommendations being put forward are intended to improve supports for SMOs in Canada, recognizing the important role played by such organizations. They should not be seen as “me too-ism” – seeking supports for SMOs simply because they are available for SMEs.

Rather, they are intended to address important challenges and barriers faced by SMOs in effectively fulfilling their role in communities across Canada. The recommendations are being made in response to market imperfections, identified needs, and gaps in supports. They take into account the important differences between SMEs and SMOs while seeking to take advantage of experience and knowledge of “what works.”

Some of these recommendations, of course, are not new, in that they reflect concerns and issues that have often been identified by the nonprofit sector.

It is hoped that by drawing on the comparison with SMEs, as well as data on SMOS in Canada that have not previously been examined in-depth, this study will serve to move the yardsticks a little further in terms of building a strong and vibrant SMO sector in Canada.

It is also recognized that there are a large number of recommendations being put forward and that priorities will need to be set among them, in consultation with the sector itself.

It must be noted as well that there is a wide variation in the capacities of SMOs and the challenges they face; smaller organizations and those with no paid staff, for example, have vastly different needs than those that are medium-sized. “One-size-fits-all” solutions will not work in the case of SMOs, any more than they do for SMEs.

Finally, it is recognized that a system of effective and comprehensive public supports for SMOs will have to be built, as was the case for SMEs, over a period of time and on the basis of sound data and research and the testing of new initiatives.

The recommendations are grouped in six major areas that emerged from the research examining the supports for SMEs and how SMOs could be similarly strengthened:

- i. Improving our knowledge and understanding of SMOs
- ii. Providing information, tools, advisory and support services
- iii. Facilitating and leveraging access to financing and improving financial supports
- iv. Supporting innovation and technology
- v. Supporting networking and partnerships
- vi. Addressing regulatory and other concerns

For each area of recommendation, the policy rationale for such supports is briefly re-capped; where appropriate, examples of existing or embryonic supports are provided from Canadian or international experience; and, in addition to the broad policy direction proposed, a number of possible specific initiatives are identified.

(i) Improving our knowledge and understanding of SMOs

This study of SMEs and SMOs in Canada has identified a number of important gaps in our knowledge and understanding of SMOs.

Overall, while there is an abundance of information available on SMEs, as well as considerable knowledge about the nonprofit and voluntary sector as a whole, there is a dearth of knowledge when it comes to the specific contributions and challenges of small and medium-sized nonprofit organizations.

Governments, universities, research organizations and others have initiated efforts to improve data and information on the charitable and nonprofit sector. This includes: the National Survey of Nonprofit and Voluntary Organizations (NSNVO); the Satellite Accounts; the Canada Survey of Giving and Volunteering; and interdepartmental work now underway, led by Human Resources and Social Development Canada, to examine how to get better data on the sector.

Although the analysis presented in this report provides a high-level portrait of SMOs, there is a need for more detailed data collection and analysis, and to develop a more comprehensive measure of the social contributions of nonprofit and voluntary organizations. Studies such as the NSNVO and the Satellite Accounts help to describe the contribution of the sector from an economic perspective, but shed little light on its immense social contributions.

We also need to have more data and understand more about the different sub-segments of the SMO population – size categories, for example – if public policy makers are to be able to develop appropriate policies and supports that address specific needs and situations.

Recommendations to improve information and data about SMOs include:

- Develop a more comprehensive approach and plan for collecting and analysing data on SMOs, including sub-segments, and on the charitable and nonprofit sector more generally, on an on-going basis.
- Improve the integrity of Canadian Revenue Agency (CRA) data on organizations and to convert it to a longitudinal database.
- Provide support for organizations for compliance with CRA requirements and for completing CRA forms, recognizing that CRA has introduced recent initiatives to help address this.
- Provide funding for the NSNVO on an on-going basis.

Areas for further policy-research include:

- Development of tax measures to encourage investment in the sector.
- Testing of approaches to support key areas: tools and information/advisory services; networking/partnerships; pooling/sharing of resources and services (e.g. “hub” approach); innovation capacity-building, “exporting” of innovations; technology acquisition/use by SMOs.
- Testing of different approaches to address funding issues, such as “passporting”, full cost-recovery for actual operational costs in project and service-delivery funding, etc.
- Longitudinal data and research on the workforce in the charitable and nonprofit sector.
- Data and analysis on the financial and legal risks associated with nonprofit organizations, relative to liability insurance issues.
- Development and testing of a practical results-based accountability framework.

(ii) Providing information, tools, advisory and support services

While financing is a key issue for SMOs, many of the challenges faced by small- and medium-sized charitable and nonprofit organizations could be addressed at least in part, as in the case of SMEs, by various non-financial services and supports, such as: the provision and sharing of information, knowledge and technical assistance; access to consultative, advisory and referral services; the development of practical tools and instruments; and access to other services and supports.

Governments in Canada have taken action to improve these kinds of supports for SMOs; for example, through initiatives further to the *Voluntary Sector Initiative* at the federal level; the funding of a Human Resources Sector Council by Human Resources and Skills Development Canada; and Alberta's Volunteer Services Branch, with ten regional offices providing assistance with volunteer programs and services.

Recommendations to address this gap in current supports for SMOs include:

- Make **information, expertise, technical assistance, and consultative, advisory and referral services** widely and easily available to SMOs, as is the case for SMEs (e.g. through *Canada Business Service Centres* and the *Business Development Bank of Canada* as well as the regional economic development agencies). Consideration could be given to expanding and adapting existing SME services to respond to the needs of SMOs and/or developing SMO-specific services and supports.
- Provide an extensive array of **on-line, “one-stop shopping”** information services, tools and links for SMOS, similar to [Strategis](#) for SMEs, either by expanding/adapting [Strategis](#) or supporting the development and operation of a SMO-specific web portal or links.
- Develop and provide **tools and specialized supports** for SMOs in key areas such as management, human resources, financial accounting, reporting systems, working with boards of directors, and managing and developing volunteer resources.
- Develop and provide supports to meet the specific **human resources** development and training needs of SMOs, such as needs identification, self-assessment, inventories of available training and development, linkages to universities and colleges, etc.

(iii) Facilitating and leveraging access to financing and improving financial supports

Given their nonprofit nature and mission to serve the community and deliver key public services, including services on behalf of government, access to appropriate and adequate revenues is a key challenge for SMOs.

Organizations experience significant difficulties accessing commercial and private financing sources, and the market seems unable, as in the case of SMEs, to respond adequately to their needs and circumstances.

Governments in Canada have undertaken a number of initiatives to assist SMOs in diversifying their financing. For example, The Government of Canada has announced its intention to allow social economy organizations to access some SME financing support programs, and to establish a *Charity Bank* to facilitate access for charitable and nonprofit organizations to private financing.

SMOs have also identified a number of critical issues regarding government funding, including the reliance on short-term, project-based funding, lack of funding for operational costs, and overly-burdensome accountability/reporting requirements.

To address these concerns, governments in Canada have taken a number of actions. For example, at the federal level a Code of good funding practices has been developed further to the *Voluntary Sector Initiative*. Human Resources and Social Development Canada has created a task force to examine models of community investment. Service Canada, which administers 55,000 contracts, has set up a "fairness advisor" and a voluntary sector advisory committee and is working with the Code on Funding. Quebec has introduced a number of policy initiatives to improve funding for community organizations, including renewable funding and support for operational capacity development.

The following recommendations identify a number of ways to facilitate and leverage private and other sources of financing for SMOs and to improve government funding support. The recommendations draw on SME examples and experience and also address specific needs and issues that have been identified for/by SMOs:

Access to private financing and support for diversifying financing sources

- Develop loan and loan guarantee programs for SMOs, either by providing access to existing SME programs and/or new initiatives designed for SMOs.
- Introduce or expand tax initiatives to encourage and leverage private investment and make investment in SMOs and more attractive and practical for private investors and institutions and foundations. These could include extending the preferential tax treatment on capital gains to other types of capital assets (e.g. real estate) and to private foundations, and providing a complete tax exemption on capital gains for charitable gifts of publicly-traded securities.
- Proceed with the implementation of the announced *Charity Bank*.
- Facilitate access to greater diversity of financing sources through initiatives to bring organizations and financing/investing parties together, such as the development of "angel" investor networks; assistance in developing and presenting a business case and in measuring and reporting returns; assistance in "talking the language of finance"; and other financial-related tools and supports.
- Provide regulatory, taxation, financial, procurement and other support for social entrepreneurship models to assist SMOs in exploring and developing revenue-generating activities and initiatives.

Improving government/public sector funding

- Where SMOs deliver public services on behalf of government, the funding model used should provide full cost recovery for overhead and administrative costs for the programs and services being delivered by organizations. Measures to implement this recommendation could include:
 - Models such as the UK's *Compact* approach to operational costs
 - Multi-year funding agreements
 - Renewable funding

- Measures to improve “front-end” processes, such as the UK’s “passporting” system for organizations with a “track record.”
- Where governments provide on-going funding for organizations whose mission directly supports the mandate and policy objectives of the government department/agency, the funding model should provide for sustainable operational funding that recognizes the operating costs of organizations. Initiatives could include:
 - Multi-year funding commitments and renewable funding
 - Funding models such as Quebec’s community action policy model
 - Measures to improve and streamline administrative processes

Finally, it is recommended that, in collaboration with the charitable and nonprofit sector, a practical **results-based accountability** framework be developed, as well as measures to improve application/approval and reporting processes for government funding and reduce administrative red tape and the paper burden on organizations. This should build on the work and recommendations of the *Voluntary Sector Accord* and *Code of Good practices on Funding*.

(iv) Supporting innovation and technology

Research points to innovation as perhaps the key factor for SMEs’ growth and financial success. Investing in R&D, supporting the development and use of sophisticated technologies, and fostering the development of “clusters” of firms are ways that government encourage and assist innovation capacity in SMEs.

For SMOs, social innovation is part-and-parcel of what they are all about, how they perform their role in society. Yet, financial constraints, management and human resources capacity issues, access to technology, government funding practices and other factors are impeding organizations’ ability to innovate and develop creative solutions to community needs.

Governments have begun to take a number of initiatives to encourage and assist innovation in and by SMOs. For example, Ontario’s Volunteer Action Online program helps build the technological capacity of organizations; Quebec has introduced funding for new and innovative services; and Human Resources and Social Development Canada is examining ways to promote innovation in the community sector.

Possible initiatives to support social and community innovation by SMOs could build on existing programs and supports for SMEs and/or take the form of SMO-specific initiatives:

- Provide financial support to assist SMOs in developing organizational capacity for innovation and for testing creative and innovative responses and solutions to community and individual needs.
- Introduce more flexible funding criteria and program terms and conditions to encourage risk-taking and the development and testing of creative solutions.
- Provide financial assistance to assist SMOs in acquiring modern technologies and developing their technological capacity, including the training and development of staff.
- Use tax measures to encourage investments in innovative capacity and technology.

(v) Supporting networking and partnerships

The development of effective networks and partnerships is an important success factor for both SMEs and SMOs: they are key for innovation; they help organizations identify and address needs, challenges and barriers on a collaborative and collective basis; and they help organizations build skills, acquire and share information, knowledge and expertise, and pool resources to reduce costs.

The concept of local “hubs”, providing incubation, supports and pooling opportunities, can be based on common-service providers or on organizations themselves designated to serve as a focal point for particular services or functions. In the United States, for example, Management Service Organizations (MSOs) in many cities provide shared services on a fee-for-service basis, and several Canadian cities are exploring a similar model.

Possible initiatives to support networking and partnerships include:

- Provide financial and other support for initiatives to facilitate and increase collaboration among SMOs to respond to common issues and needs and develop tools to address them, e.g. staff and volunteer training and development, recruiting and working with boards of directors, management development, etc.
- Building on existing and emerging organizational and geographic networks, provide financial and other supports for the pooling or sharing of resources, knowledge and expertise, e.g. financial and human resources management systems, new technologies, and specialized skills, beginning with the development and testing of a number of demonstration models.
- Provide financial and other support for sharing and “exporting” community innovations
- Provide financial and other support for the development of organizational infrastructure, supports and services (e.g. associations, umbrella and “intermediary” organizations).
- Provide financial and other support for sectoral partnerships and initiatives (sector councils, sectoral studies), including research, identification of needs, development of tools and other supports.

(vi) Addressing regulatory and other concerns

Regulatory and other issues are frequently identified by SMOs as real barriers to success. These include certain tax policy provisions and interpretations, access to government business, and liability insurance.

Governments have introduced various measures to begin to address these concerns. For example, the Canada Revenue Agency (CRA) has created an Advisory Committee of sector representatives and established a new program and advertising initiatives to build awareness on regulatory requirements; the Government of Canada has developed a new procurement policy and related supports; Ontario’s Volunteer Linkages program, established in 1997, seeks to simplify the incorporation process for charitable and nonprofit organizations; volunteers in B.C. may be covered by an accident and liability insurance plan.

Possible initiatives for further action to address regulatory and other concerns include:

- Re-examine the definition of “charity”, especially with regard to the many organizations that provide a public benefit without meeting the current criteria.

- Re-examine Revenue Canada restrictions on allowable business activity for charities.
- Develop further measures to allow and assist SMOs to access and compete for government business and contracts.
- Review and reform liability insurance for nonprofits, e.g. collect data and do analysis on risks, for fairer evaluation of premiums; consider private or government-run nonprofit insurance pools.

Conclusion

This report summarizes the key findings and recommendations of the research study on SMEs and SMOs in Canada undertaken by Imagine Canada and Canadian Policy Research Networks (CPRN), with the financial support of Human Resources and Social Development Canada.

Further information, data, analysis, research sources, and learnings from key informant interviews are presented in separate papers.

The Imagine-CPRN research study underscores the importance of SMES and SMOs in Canadian society and the economy and identifies similarities between them as well as differences in terms of their characteristics and success factors.

While the study describes the vital contribution to society and the economy that is being made by SMOs in Canada, many organizations are struggling to deliver their mission. They face financial challenges due to limited access to financing sources and government/public sector funding models that do not adequately support their core operating costs or the actual costs of service delivery. They face significant management and human resources challenges, including insufficient numbers of paid staff; staff training and development needs; and needs relating to the recruitment, training and retention of volunteers. Often organizations work in isolation and have limited access to needed expertise and knowledge and to new technologies.

As a result, the ability of charitable and voluntary organizations to champion and lead social innovation at the community level in Canada is being tested.

A number of policy recommendations are put forward in this report, directed at governments in Canada, federal and provincial/territorial, as well as to the private sector, communities, and organizations themselves, while recognizing that a comprehensive system of effective supports will have to be built over time and that it will need to respond to the great diversity of needs and situations of SMOs.

It is hoped that this research study and its recommendations will help to support the development of a strong and vibrant SMO sector in Canada as an essential and significant contributor to the quality of life and well-being of Canadians and community health and vitality.

Summary of Major Recommendations

The following recommendations build on recent trends and initiatives, and recognize that a comprehensive set of supports will have to be put in place incrementally over time, based on needs, good data, and appropriate testing.

Further research, data/information, and policy development needs

1. Develop a plan for on-going data collection and analysis on SMOs in Canada and for comprehensive measures to assess the contribution of SMOs to Canadian society and the economy.
2. Improve the integrity of CRA data and convert it to a longitudinal basis. Provide supports for organizations to assist them in complying with CRA data requirements.
3. Provide funding for the NSNVO on an on-going basis.
4. Collect and analyse data on the financial and legal risks associated with nonprofit organizations, relative to liability insurance issues.
5. Undertake further policy-research on tax measures to encourage investment in the charitable and voluntary sector, and develop and test approaches in key support areas such as tools and information/advisory services and products for SMOs, networking and partnerships, pooling and sharing of resources and services, innovation, and technology.
6. Develop and test different approaches to address funding issues, such as “passporting,” inclusion of actual operational costs in project and service-delivery funding, and approaches to core funding support, and a practical results-based accountability framework.

Information, tools, advisory and support services

7. Make information, expertise, technical assistance, and consultative, advisory and referral services widely and easily available to SMOs, either through existing agencies and institutions that provide such services to SMEs and/or through new SMO-specific initiatives.
8. Provide on-line, one-stop information, tools and links for SMOs, either through expansion and adaptation of Industry Canada’s *Strategis* or through a SMO-dedicated web portal.
9. Develop and provide SMO-specific tools and specialized supports in key areas such as financing, management and human resources development.

Access to financing and improving government funding supports

10. Provide financial and other supports – including loan and loan guarantee programs, tax measures, and technical assistance, tools and information – to assist SMOs in diversifying their financing, encourage and leverage private investment, and address identified financing gaps.

11. Provide full cost recovery for the actual overhead and administrative costs for programs and services delivered by organizations on behalf of government.
12. Provide sustainable funding that recognizes the operating costs of organizations when on-going government funding is provided for organizations in respect of their mission/mandate.
13. Develop, in collaboration with the charitable and nonprofit sector, a results-based accountability framework and take action to improve administrative processes and reduce paper burden and red tape.

Innovation and technology

14. Provide financial assistance to SMOs to strengthen their innovation capacity and to test and share successful social and community innovations.
15. Ensure appropriate flexibility in funding criteria and program terms and conditions to encourage the development and implementation of innovative and creative responses to community needs.
16. Provide financial assistance to SMOs to acquire and exploit new technologies.
17. Use tax measures to encourage investments in innovative capacity and technology by SMOs.

Networking and partnerships

18. Provide financial and other supports for the development of organizational infrastructure and institutional supports among SMOs and sectoral and community networks and partnerships.
19. Provide financial and other supports for initiatives to facilitate and increase collaboration among SMOs to address common issues and needs such as staff and volunteer training and development, develop tools to respond to them, and pool and share resources, knowledge and expertise.
20. Support partnerships among SMOs and with other community players and government institutions to encourage the sharing of knowledge and resources in developing innovative solutions to community issues and for sharing and expanding successful innovations.

Regulatory and other issues

21. Re-examine the definition of charity and restrictions on allowable disbursements and on advocacy/public policy activities for charities.
22. Review and reform liability insurance for nonprofit organizations.
23. Develop measures to allow and assist SMOs to access and compete for government business and contracts.