Financing Social Enterprise
An Enterprise Perspective

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A research report prepared for the Northern Ontario, Manitoba, and Saskatchewan Regional Node of the Social Economy Suite

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FINANCING SOCIAL ENTERPRISE

AN ENTERPRISE PERSPECTIVE

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WORKING PAPER

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INTRODUCTION

There is a change afoot – a convergence between the world of the for profit business and the socially motivated non profit – and it is giving birth to a new form or organization called the social enterprise.

This paper is the second stage in a two part exploration of social enterprise financing in Manitoba, Saskatchewan and north-western Ontario. The first report (Wuttunee, Rothney, Gray. 2008) looks at sources of finance for social enterprise. This paper focuses on financing from the social enterprise perspective, including a brief discussion of the financing strategies as they change throughout the life of the enterprise.

Through case studies, we profile four social enterprises operating in the City of Winnipeg, highlighting key elements in their history and strategies. The focus here is on independent social enterprises, as opposed to enterprises that are somehow affiliated with a social service agency or charitable organization. These stories reflect some of the common experiences of small enterprise start-up and development.

WHAT IS SOCIAL ENTERPRISE?

Many people equate social enterprise with non-profit. The term frequently refers to market based, revenue generating ventures that operate within the umbrella of non-profit organizations.

The definition used for this study is slightly different. Under this definition (Wuttunee, 2008. p1.), ownership and legal status are not the defining criteria. Social enterprise can take on any organizational form: a for profit business, a cooperative, a partnership, a sole proprietorship or it could be a revenue generating arm of a non-profit organization.

The key distinctions between this view of social enterprise and other revenue generating organizations operating in the for profit and non-profit worlds are as follows:

- Social enterprises are active participants in the market economy, offering goods or services with the intention of earning profits (or surpluses).
- Social enterprise places strong emphasis on social and environmental objectives in addition to the financial objectives. This is commonly referred to as the blended return or double bottom line, and triple bottom line where environmental objectives are included.
- The enterprise will have a clear plan for the application of profits or surpluses towards the social or environmental objective(s).

Within this perspective, a social enterprise is essentially a business that is dedicated to a social and/or environmental mission. This is the “blended mission” enterprise. It is subject to the same risks that for profit enterprises face, along with some additional ones that are attached to the social mission. Balancing the demands of the market place against the demands of the social goals is a big challenge. If small business is risky (and it is, especially in the start-up stages), then social enterprise is more so.

With all other things being equal, one could expect that the success rate for social enterprise would be lower than for traditional business. … When including
at least one social aspect or mission in the practices of the enterprise, it is likely that operating costs would be typically higher than a traditional for-profit business. … While social goals are laudable and to be encouraged, the inherent disadvantages created by this perspective cannot be ignored (Gould, 2006, pp.12, 13).

This makes it even more important for social enterprises to develop a high standard of practice in all aspects of their operations. Emerson (1998) explains it this way:

… there is no set model for engaging in social-purpose business development. Rather, there are certain business fundamentals that cut across the field and core issues of capacity and development that organizations must address if they are to operate a successful social-purpose business (p.8).

**THE ROLE OF FINANCE**

While finance may not be the first or even the most important of these fundamentals - managerial capacity and markets come first - adequate capitalization is one of the essential building blocks.

Access to capital can make small business start-ups possible, fund enterprise expansion and create significant long-term investment in infrastructure capacity. The lack of capital investments limits growth, forces reliance upon non-diversified (and therefore high-risk) operating funds, and often dooms promising ideas before they are allowed to succeed or fail in the marketplace (REDF, 1996, p. 249).

Raising capital can be time consuming, expensive and demoralizing, especially if one is approaching the wrong type of financier. The effort is better spent dealing with financiers who are willing and equipped to work with the enterprise. Social entrepreneurs can save themselves a lot of trouble and improve their success rate by understanding the life cycle of their sector and the resources available to them at different stages of development. Grants and equity equivalents are common forms of capital in the earliest stages. “As the business evolves and gross margins improve, the business should move towards greater self-sufficiency and begin to access other more sophisticated capital instruments such as loans and equity investments” (REDF, 1996, p.225).

Though they are not really a ‘financial instrument’, internal capital sources are perhaps the most important source of all. They play an important role throughout the life of the enterprise. Internal capital usually refers to operating surpluses from the organization’s cash flow, but it may also include ‘sweat equity’ or the free labour and other resources that replace cash.

Whatever form it takes, “investment is money from financial partners who join management’s efforts to build a sustainable firm” (Overholser, 2002, p.2). It is a type of partnership between the enterprise and the finance provider.

The appropriate mix of financial instruments will vary, depending on the business and its stage of development, but it is usually best if the capital base is somewhat diversified,
with a mix of grants, debt, equity and equity equivalents. The balance between debt and equity determines the capital structure of the enterprise and the debt to equity ratio is one of the main indicators used by lenders to determine credit worthiness. A diverse and well balanced financial base helps protect the enterprise from shifts in the capital marketplace (Emerson, Dees, et al, 1999, p.194).

Grants are often seen as free money because there is no interest charged on them and they don't have to be paid back. In reality, the strings attached to some grants can make them a very expensive form of finance. For example, grants that fund new or expanded program offerings may create extra costs, such as in staffing. The organization may have to divert resources from other areas which may upset the balance and create extra risk (Non-profit Finance Fund, undated, p.11).

Growth capital, also known as patient capital, is a very particular and important form of capital for social enterprises, and one that is in short supply. It provides the means to build production capacity. Sources of patient capital include friends and family (love money), developmental lenders, (i.e. Community Futures Development Corporations), Social Venture Capitalists and private ‘Angel’ investors. Patient/growth capital investors are in for the long haul, and they usually expect lower rates of return than most investors. It supports the enterprise (and covers the deficits) until it reaches financial sustainability.

Overholser (2002, p.3) stresses that sustainability is reached when “there is enough cash flow from revenues to reliably cover the firm’s ongoing expenses. … and further injections of capital are no longer needed to sustain the firm.” He emphasises that revenue from customers is the source of sustainability, not investment (grants, loans, equity etc).

FIVE STAGE ENTERPRISE DEVELOPMENT PATH

The Community Development Path model, illustrated in the diagram below, depicts the life cycle of an enterprise in terms of five stages, each with its own set of financing challenges and potential solutions.

![Community Enterprise Development Path Diagram](Source: Van City Community Foundation)

These stages of development require different types of financing as illustrated below.

**Type of Funding - Stage of Development**

<table>
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<tr>
<th></th>
<th>Seed</th>
<th>Start-up</th>
<th>Survival</th>
<th>Growth</th>
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<td><strong>Equity</strong></td>
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<td><strong>Debt</strong></td>
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<td><strong>Equity Equivalent</strong></td>
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<td><strong>Grant</strong></td>
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<td><strong>Internally Generated</strong></td>
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</table>

(Source: Van City Community Foundation)

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1 From a presentation by Wendy Rogers, Van City Community Foundation at the CSR and National Community Investment Forum, University of Guelph, May 17, 2007
2 ibid
STRATEGIES BY DEVELOPMENT STAGE

The Seed and Launch stages can be likened to birth and infancy. The enterprise requires a lot of nurturing (usually through grants and internal resources) before it can walk on its own. Development grants, primarily from government, are one of the main sources of external funding for the feasibility and planning activities. Operational grants may also provide start-up financing in some cases.

Many enterprises desperately need equity to finance the launch, and “Lack of equity to sufficiently capitalize the business and support operations during the initial period until the business generates revenue (is) a significant problem” (Enterprising Non-Profits, 2003. p.20). The initial equity base for a startup enterprise frequently comes from sweat equity and ‘love money’ (from friends and family). Unfortunately sweat equity does not scale well (Miller, 2001.p.7) and most enterprises look to external sources to move to the next level. This is a good time to begin seeking out long term investors who may be interested in providing patient growth capital to support the enterprise through the long term.

During the Survival stage, revenue and organizational capacity are developing and it is starting to feel like a real business. Growth either accelerates through this stage, or the venture withers (Flannery, 1999. p.20). As the enterprise develops and matures, debt and equity take on a more important role.

At the Growth stage, demands for capital increase considerably. Normally the finance options grow too. With an established market and sustained cash flow, debt financing becomes more readily available, providing there is sufficient cash flow to support it.

In maturity, the organization is able to tap mainstream financing. It will qualify for lines of credit, major capital and equipment loans and other forms of traditional lending (Emerson, 1999.p.194).

PART 2: CASE STUDIES

When people speak of social enterprises, they commonly think of enterprises that operate under the umbrella of a non-profit organization.

The four Winnipeg enterprises profiled in this document do not reflect that model. These have developed as independent, market driven entities with blended financial and social objectives. Winnipeg is somewhat unique in the number of social enterprises that did not grow out of a non-profit organization.

The enterprises are profiled using the framework provided by the Community Enterprise Development Path identified earlier in this paper. The information was drawn mainly from conversations with the social entrepreneurs who helped found and currently manage the enterprises. These conversations occurred as part of a roundtable discussion on November 8, 2007 as well as in-person interviews, telephone conversations and site visits between September 2007 and January 2008. This material was supplemented by information taken from the print literature and websites of the companies and their affiliates.
The key informants and their website addresses are:

- **Inner City Renovation:**
  Marty Donkervoort, general manager
  www.icdevelopment.ca
  and its partners:
  Community Ownership Solutions: www.communityownershipsolutions.com
  Social Capital Partners: www.socialcapitalpartners.ca
  North End Housing Project: www.nehp.mb.ca/

- **Natural Cycleworks:**
  David Geisel, founding member and lead mechanic
  www.naturalcycle.ca

- **Neechi Foods:**
  Russ Rothney, treasurer
  www.arch.umanitoba.ca/greenmap/pages/GrnMapPl_msNeechi

- **Tall Grass Prairie Bread Company:**
  Lyle Barkman, co-owner, co-manager and master baker
  www.tallgrassbakery.ca
CASE STUDY: INNER CITY RENOVATION

Ownership structure: an operating division of Inner City Development Inc. (ICD)
Industry: construction, residential and commercial renovations
Formation: 2002
Governance: Board of Directors: five directors representing community groups, business, labour, educational institutes and the City of Winnipeg
Social objectives: quality jobs for low income people

Inner City Renovation (ICR) is a frequently studied social enterprise due to its innovative organizational structure and the high profile of its owners and managers.

True to its name, the company is in the commercial and residential renovation and construction business working primarily in the Winnipeg inner city and north end. Projects have ranged in size from a few thousand dollars to more than half a million dollars.

ICR is a vehicle for providing employment to low income inner city residents in the Winnipeg north end. The social mission includes a number of specific job related goals including:
- quality full time employment to low-income inner city residents
- better-than-average sector wages and benefits
- education and training, leading to skills and certification for its workers
- opportunities for advancement and career laddering
- participatory management culture
- employee ownership in the social enterprise which will be triggered once the business unit is stable and has two consecutive profitable years

Seed Stage

Inner City Renovation is a very complex example of a social enterprise structure. The company was conceived through Community Ownership Solutions (COS), a non-profit development corporation with charitable status.

COS is a product of the now defunct Crocus Investment Fund, a Manitoba labour sponsored investment fund. It was designed as an incubator of social enterprises with a job creation mandate. Since its startup in 1999, COS has raised over $1 million from a variety of sources, including the Crocus Fund, the Winnipeg Foundation, the Manitoba government, the United Way, Cooperators Insurance, the Winnipeg Partnership Agreement (WPA) and anonymous donors. Some (not all) of this money has been used

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3 COS attempted to start two other social enterprises, a property management and a janitorial firm. These proved non-viable and have since been closed.
to support ICR. Some was used for COS operations and some for pursuing other avenues of poverty alleviation.

Marty Donkervoort has been the main driver behind both ICR and COS. With an MBA degree and a wealth of experience in community development, Donkervoort has more background than most social entrepreneurs launching a new social enterprise. He prepared the feasibility analysis and business plan for the new venture.

Start-up/Launch

Social Capital Partners\(^4\) (SCP), a private social venture capital firm, sponsored a business plan competition for social enterprises. Donkervoort submitted the ICR plan and won. The prize was $15,000 cash and a commitment for up to $1 million financing from SCP. He calls it a “charmed” beginning for ICR.

Ownership in ICR was divided equally between three non-profit community development organizations: COS and North End Housing Project\(^5\) (NEHP), both registered charities, and SCP.

Each of the partners brought a particular expertise to the venture, in addition to their capital contribution. ICR provided the plan and the management capacity. NEHP provided an instant market for the ICR services and SCP brought capital and financial expertise. The company could not have started or survived without that support from its partners, says Donkervoort. Bringing SCP into the group was a real breakthrough. In addition to the money, their involvement brought invaluable business skills and experience to the Board of Directors, along with technical support and advocacy.

Start-up/Survival

Despite the deep pockets and strong support from its backers, the company still struggled with the common dilemma of social enterprise - sacrificing profits to meet its social objectives.

The education, training and social objectives result in lower workforce productivity and higher costs compared to their competitors in the industry. Government education and training grants, accessible to most businesses, cover a portion of the training costs, but not enough to offset all of the cost associated with the social mission objectives.

In addition to paying above average wages, ICR provides a generous employee benefit package, apprenticeship programs and secure employment. This also impacts

\(^4\) Social Capital Partners is a private equity investor. It invests in social enterprises that employ populations outside the economic mainstream in Canada. SCP founder Bill Young made his fortune in the high tech sector prior to the 2000/01 technology stock market melt-down. He now uses his financial experience and resources and his business connections to support employment development and social economy goals.

\(^5\) The North End Housing Project (NEHP) is a non-profit organization that purchases and renovates older houses, or builds new infill housing, for lease and resale to people with low and modest incomes. NEHP renovates about 20 houses per year.
competitiveness in an industry where many workers are employed on a project basis and do not receive any of these benefits.

There are other unexpected costs associated with this social mandate. About 6 months into the launch they hired a part-time Aboriginal social worker to provide social supports to the workers in their transition to employment. “If you are working with the same demographics as we are, having access to a social worker to provide supports is crucial,” says Donkervoort.

Similar to the financial accounting reports required of most organizations with shareholders, the social enterprise produces ongoing social accounting reports to the charities that support it. ICR completes an annual social audit that reports on growth and improvement in areas such as health, housing, employment, etc.. Social return on investment (SROI) reporting is one of the conditions for financing from SCP. The SROI Report Card is presented to the Board of Directors who closely monitor the social mission objectives alongside the financial objectives.

From the social enterprise perspective, the financial and non-financial benefits paid to the workers are essential, says Donkervoort. Assuming these extra costs is clearly not an economic decision. It flows out of the social mission. “If the social enterprise is willing to forfeit profits to take care of the extra expenses, then maybe it can breakeven, he says. But if those expenses are greater than the potential profit, it must have other resources to draw on.”

ICR uses funds from foundations, private sector grants and government subsidies to offset those extra costs. COS is able to transfer funds from the charity to the social enterprise to support the education and training costs. Those funds become taxable in the hands of the social enterprise.

Growth/Profitability

In 2007, its 5th year of operations, ICR recorded two consecutive quarters of profitability. With gross revenues of approximately $2 million in 2007, working capital is a serious concern. Donkervoort tries to manage cash flow by stretching payables out 60 to 90 days. He considers this free money, though it is a risky strategy that may jeopardize the company credit rating and relationships with important suppliers.

The lack of capital to obtain a performance bond was limiting growth opportunities. (Performance bonds are a form of insurance that is required for bidding on large construction projects.) Most insurers require $2 million to $4 million in assets to secure a $1 million performance bond. ICR did not have sufficient internal resources to qualify so The Cooperators insurance company assumed that risk and provided the bond as part of its commitment to the principals of corporate social responsibility and community economic development.

Similarly, for the past 3 years COS has provided the $30,000 cash deposit required for participation in the New Home Warranty Program of Manitoba. This allows ICR to take on new home construction projects.

SROI Report Cards are available at http://www.socialcapitalpartners.ca/sroi_reports.asp
Maturity

As ICR approaches the maturity stage along its development path, it faces the challenge of succession. Donkervoort is looking forward to retirement within a few years. Who will step into his position?

The champion who starts the enterprise is not usually the one to institutionalize it, says Donkervoort. This usually requires a new leader, and no successor has been identified for ICR. “Succession will inevitably become a major issue for the ICR Board of Directors” (2006, p.23).

Mission Accomplished?

From its beginning in 2002 the enterprise has been making good on its social objectives, creating 20 to 30 full time year round jobs. The company has generated more than $6.5 million in earned revenue from about 175 projects and paid out more than $2.5 million in wages and benefits to its employees. They have rejuvenated several buildings in the inner city, contributed to the local economy by sourcing materials and services and provided formal and informal training to all of the employees. In 2007, after five years of operations, it started to deliver financial results as well. How it will survive the future succession challenge, remains to be seen.

Inner City Renovation: Enterprise Development path

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<th>STARTUP Survival</th>
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<td>Government training grants</td>
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<td>Co-operators • $20,000 grant • Performance bond</td>
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<tr>
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<td>COS deposits $30,000 to New Home Warranty Program</td>
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CASE STUDY: NATURAL CYCLEWORKS

Ownership structure: incorporated as a Worker Cooperative

Industry: bicycle courier, bicycle parts & repair service

Formation: 1999

Governance: democratic structure, consensus decision making

Social objectives: financial sustainability within an ethical moral framework, particularly environmental sustainability and labour equity

During the late 1990’s a small group of friends and environmentally committed bicycle enthusiasts started a bicycle courier service as a way to put their beliefs into action.

With the exception of one small product development grant, Natural Cycleworks has been built entirely upon internal financing: sweat equity and cash flow. Surpluses generated from the operation have been reinvested. With no capital base to build upon, the cash flows have been modest and profits negligible.

Seed Stage

When the worker co-operative was incorporated in 1999, the members produced a detailed Member Agreement Handbook defining the democratic, consensus based decision making model and a set of social and environmental objectives.

Their goal was financial sustainability within an ethical moral framework, based on the following principals:

- balanced relationships
- environmental sustainability
- “living wage” (which they define as double minimum wage, or about $16/hour) & labour equity
- good technology (technology that offers more labour efficiency, environmental efficiency and economic efficiency)

Start-up/Launch

The members wanted to rely upon their own resources to build the enterprise, foregoing outside financing. Equipped with their own bicycles, two riders hit the streets making deliveries to businesses in downtown Winnipeg.

“Financing can really lock you into a pattern,” says founding member David Geisel. “We wanted flexibility. We were very creative working with nothing and we enjoyed that process. For example, we reclaimed some wood from an old building to build shelving. We gained a lot of satisfaction from that.”
Although financial sustainability was identified as one of the key principals in the Membership Agreement, it did not receive the same focused attention applied to the social and environmental principals. This perspective carried over to the day to day operations, with the result that members did not draw wages from the co-operative for quite some time.

The membership agreement called for each member to purchase shares in the cooperative. Since the share purchases were done through a zero interest share purchase loan repaid through wage deductions over a 4 year period, they did not provide any operating capital.

Co-op resources consisted mainly of athleticism, youthful energy, commitment to the mission and David’s mechanical skills. Their assets were their bicycles. They kept the costs low with cheap rent in a heritage building in the old Exchange District. They completed the renovations using reclaimed materials. Friends and family contributed non-monetary supports such as free rent at home with parents, the use of tools and volunteer labour to help with the renovations.

With no capital to build upon, enterprise growth has been tied directly to cash flow and volunteer labour. The result has been slow growth in revenues, membership and in progress towards the social and financial objectives.

*Survival*

It soon became clear that the courier business is a low wage undertaking that can not deliver on their wage target. Geisel applied his mechanical skills and entrepreneurial outlook to the task and began taking in bikes for repair. The bike shop started out with “a multitool, a crescent wrench and me.” Parts sales followed as a natural extension of the repair business.

Bike shop revenues quickly surpassed the courier service. “Our commitment to keeping bikes on the road is the one area where we can excel,” explains Geisel. It is one of the key attributes that sets them apart from the competition. The bike shop team also developed a unique ‘prairie’ bike. Designed for the flatlands, it integrates the comfort features of the mountain bike with a lighter frame. They received a $2,000 community development grant from Assiniboine Credit Union to help with the prototyping and set up a machine shop for the fabrication work. This is the only external funding they have received.

In 2007, the bike shop reported $160,000 revenue: about $100,000 in parts sales, $60,000 labour sales and generated a $20,000 surplus which was reinvested into inventory. It employed 7 people at just over minimum wage.

The courier company grossed about $66,000/year in 2007 with 4 riders and a dispatcher. It operated at about breakeven and courier commissions approached minimum wage.

In 2008, the co-op continues to operate on a cash basis. They use personal credit cards for operating purposes and pay the full balances at the end of each month. “This is not
always a good way to make money work, says Geisel, but it has been part of our learning process.”

The lack of capital limits the co-operative and carries hidden costs that the workers have been inadvertently financing through low wages.

Parts inventory costs are one of the biggest expenses. Once they discovered that dead and slow moving inventory items were putting a real drag on earnings, they were able to make changes to reduce costs that will hopefully translate into increased sales and profit margins. For example, slow moving specialty parts should command a higher profit margin than the fast moving items that are in high demand.

Another example is the carrying cost on the accounts payable. The courier business operates on commission. Customers usually pay their accounts 30 to 60 days after the service has been provided. Most courier companies transfer that cost to the workers by holding back commission payments 4 to 6 weeks. Natural Cycle pays its couriers within 2 weeks of the service and finances the cost out of cash flow from the bike shop.

Growth/Profitability

At the time of writing, the co-operative was beginning to rethink some of its approaches to business. Members were taking steps to identify the inefficiencies and implement new systems to improve in areas such as inventory control and courier dispatch. They began moving towards more standardization in their processes and studying a new service model for the courier business as a way to extend its reach and gain efficiencies and scale.

The courier company, bike shop and machine shop operate as 3 business units within the Natural Cycleworks umbrella. Geisel is developing a plan for a fourth business unit, a parts distribution company that will market high quality and environmentally sustainable products to specialty shops across the country. This will give them access to the type of parts they need to serve their clients and support their objectives in the bicycle shop. The distribution enterprise may require greater financial resources than the co-operative can provide out of its existing operations and may require a shift in the self financing policy.

Mission Accomplished?

Natural Cycle has not yet achieved its “living wage” target and is constantly striving to balance the sometimes conflicting demands created by the environmental and social goals and the financial goals.
Natural Cycleworks: Enterprise Development Path

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<th>STARTUP Survival</th>
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<td>Member shares purchased through 4 year share purchase loan</td>
<td>Bike repair shop operates at courier location</td>
<td>Bike shop surplus, $20,000, reinvested into inventory</td>
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<td>Co-operative Membership Agreement adopted</td>
<td>Building renovations with unpaid and volunteer labour</td>
<td>Parts inventory growth and retail sales business financed by operational cash flow</td>
<td>Member earnings above minimum wage</td>
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<td>Courier riders supply own equipment and work on unpaid basis</td>
<td>Courier service breakeven</td>
<td>Machine shop startup with $2,000 ACU grant for prototype fabrication</td>
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<td>Personal credit cards used for operating line of credit</td>
<td>Member earnings reach minimum wage</td>
<td>&quot;Living wage&quot; target</td>
</tr>
</tbody>
</table>

- **1999**: Worker Co-op Incorporation, Co-operative Membership Agreement adopted.
- **1999**: Member shares purchased through 4 year share purchase loan.
- **2005**: Building renovations with unpaid and volunteer labour.
- **2007**: Courier riders supply own equipment and work on unpaid basis.
- **2008**: Personal credit cards used for operating line of credit.
- **1999**: Bike repair shop operates at courier location.
- **2005**: Parts inventory growth and retail sales business financed by operational cash flow.
- **2007**: Courier service breakeven.
- **2008**: Member earnings reach minimum wage.
- **Future plans**: Bike shop surplus, $20,000, reinvested into inventory.

Courier service zone system reorganization.
Parts distribution unit investigated.
"Living wage" target.
CASE STUDY: NEECHI FOODS CO-OP LTD.

Ownership structure: worker cooperative

Industry: neighbourhood grocery store and catering service


Governance: worker members

Social objectives:
- Aboriginal community economic development
- contribute to the economic development and revitalization of Winnipeg’s inner city
- provide a safe and supportive work environment for members to take leadership roles
- provide neighborhood residents with low cost, healthy food supplies

In its 18th year of operation, the Neechi Food Co-op is finally within striking range of a long standing sales target of $600,000/year. There have been significant profits in the past few years and in 2007 they achieved record sales of $586,000. However, for most of its history the Co-op has struggled with mere cash breakeven status. Twelve worker members own, manage and operate the enterprise. Most of them are Aboriginal people living in the area.

It has been a long and difficult struggle for the Winnipeg worker co-operative and a powerful demonstration of resilience and perseverance under some of the most difficult economic conditions in this country.

Neechi means “friend” in the Cree and Ojibwa languages, and the co-op has been a friend to the neighbourhood people who live in the impoverished Lord Selkirk Park Housing Development in north end Winnipeg, by providing a safe place to purchase quality nourishing food at affordable prices.

Throughout its history, Neechi Foods has followed a self reliant strategy. Its operations been almost entirely driven by market revenue. At startup, some capital grants from government agencies were used to help finance the building and equipment.

Seed/Planning Stage

Neechi emerged out of the Métis Economic Development Training Program during the 1980s, led by economic development officers and local project groups. A worker co-operative structure was used because the highly transient population in the area did not provide a solid enough membership base to support a consumer co-operative and because it placed responsibility in the hands of the people who knew the business best.

It began operations as a pilot project in the winter of 1987/88, with a small loan from a sister co-operative, Payuk Inter Tribal Co-op (a local housing co-op). Every second
Saturday they would set up tables and bring in food stuffs to sell to community residents. The objective was to get a feel for the ordering process, till operations, customer service requirements and so on.

Start up/Launch

In 1989-90 the cooperative purchased a building, equipment, truck and inventory for about $300,000. It was financed with a $100,000 mortgage through Assiniboine Credit Union, $40,000 in community loans and the remainder in capital grants from Native Economic Development (now Aboriginal Business Canada) and the Winnipeg Core Area Agreement (predecessor to the Winnipeg Partnership Agreement\(^7\)). The community loans were in amounts of $50 to $5,000, from people interested in community economic development. The loans were initially set up as subordinated debt with favourable or zero interest rates. Some of the loans were forgiven and converted into pure equity.

Delays in government capital grant funding created tremendous problems for the co-op. In one case, a City renovation support program (that was normally used to finance large capital infrastructure programs) had so much red tape, “it treated a grant of $39,000 as if it was a multimillion dollar capital works program,” says Neechi Treasurer Russ Rothney. The funds were not received until 10 months after they were needed.

In a second case, Neechi’s community loans were initially accepted as equity equivalents for federal capital grant eligibility purposes. Later, as the application moved up the ladder of government authority, the decision was reversed and the community loans were deemed not eligible. This caused many months of delay in funding until that decision was overturned and the original approval was restored. Working capital was burned up during the delays, causing long term difficulties and hardship for the co-op.

This experience reveals some of the kinds of difficulties that can arise when social enterprise financing is crammed into preexisting financing models, says Rothney, rather than through programs that are flexible and designed to meet their needs.

In 1991, the Mennonite Central Committee (MCC) stepped forward with a loan guarantee to secure a $20,000 contingency loan from Crosstown Credit Union. This helped to develop and support a supplier relationship with the Kagiwiosa Manomin Wild Rice Co-operative in Ontario. The loan provided bridge financing on an anticipated, but initially rejected, loan guarantee from Manitoba’s Cooperative Loans and Loans Guarantee Board. The MCC loan was paid back over about 10 months. In retrospect, the MCC intervention helped keep the doors of the store open during what was to become a very difficult time.

Neechi’s first 2 years coincided with a general economic recession, but this initially did not have a big impact on this economically challenged neighbourhood. At the beginning sales grew quickly and wages were set at 35% above minimum wage. Then in 1992, as the recession began to ease elsewhere, the neighbourhood situation deteriorated badly.

\(^7\) Winnipeg Partnership Agreement (WPA) is a tripartite urban development agreement for the City of Winnipeg. Grant funding is focused on projects and enterprises that address community development, technological innovation, opportunities for increased participation by the Aboriginal community, and downtown renewal priorities.
Crime, drugs and gangs moved into the Lord Selkirk Park area with a vengeance. Families fled the area and many public housing units were boarded up.

**Start-up/Survival**

By late 1992 it looked like Neechi would have to close. It had exhausted its working capital resources and the only way out was for the workers to accept a 25% pay cut, down to minimum wage. By deciding to take this pay cut, the workers saved the co-op about $250,000 in reduced operating costs over the decade, and allowed their enterprise to survive.

In addition to the collapse of the neighbourhood, Neechi found itself up against a neighbourhood cash flow that was extremely skewed around monthly welfare payments. Welfare day is the biggest sales day in the store. So much purchasing focused on one day means that the co-op must finance a lot of inventory to support just one day of sales. It also means that sales are not nearly as high as they likely would be if neighbourhood income were more evenly distributed on a weekly or biweekly basis.

In 1994, a private individual stepped in with a $40,000 loan. The cooperative made interest only payments on the loan until 2000 when the lender offered to convert the loan to gifted equity in return for a tax credit.

Beginning in 1996, changing weather conditions started a whole new set of problems. The co-operative had built a profitable business providing bulk packaged foods to people from isolated northern communities that rely on seasonal winter roads. Warmer winters shortened the winter road season from about 10 weeks to 2 weeks, causing Neechi’s first quarter sales to drop by about $40,000 annually. At the same time, wild blueberry crops declined, undermining late summer sales by $25,000 per year.

The co-operative survived those difficult years by drawing on the equity base it had developed through the initial capital funding and the labour cost savings from the wage cuts. For years, marginal profits from the business were a lot less than the debt payments. Without capital to maintain the buildings and equipment, the assets deteriorated, with the co-op ‘living off the depreciation’. At its worst, the balance sheet showed a debt to equity ratio of 2:1.

**Growth/Profitability**

The financial picture has been improving since 2000, and Rothney reports that substantial profits were achieved in 2005 and 2006. In 2007, wage rates rose to almost 20% above minimum wage. Profits over the 3 years from 2005-07 were high enough to cover principal payments on the debt and allow for the wage increase.

Changing the balance sheet was crucial to the future success of the operation. This was made possible when, alongside the profits, the $40,000 loan from 1994 was finally
converted into equity in 2006. The Jubilee Fund\(^8\) stepped in and adopted a special process that made the transaction possible.

It took awhile, but eventually the Jubilee Fund adopted an ‘Equity Investment Framework’, which includes a provision for ‘flow-through equity donations’, and then, in November 2006, Jubilee agreed to accept funds used by Neechi to retire Bill [Loewen’s]\(^9\) loan and to donate them back to Neechi Foods Co-op as ‘contributed capital’. In so doing, the Jubilee Fund became one of the first charitable organizations in Canada to utilize CED guidelines adopted by CRA’s (Canada Revenue Agency) Charity Branch

(Jubilee Fund Newsletter, 2007, 1:1).

With this transaction, combined with the gradual reduction in debt and the jump in profits, the debt to equity ratio flipped from 2:1 to 1:2, a much more stable financial position.

**Maturity**

Looking to the future, the cooperative must now deal with the need to repair or replace its run-down assets. The building needs substantial repairs and is likely not worth the investment. Accordingly, a new business plan has been developed. The plan calls for expansion into new niche markets and new value added products and services, especially small scale customized and seasonal products and services that are resistant to competition from the major chains.

The planned expansion is expected to be financed through a combination of investment shares, debt and capital grants. Although Neechi is still a risky venture from the perspective of most commercial lenders, the commitment of the staff and the involvement of the Collaborative Co-operative\(^10\) are strong selling points when they approach socially motivated lenders like ACU, the Jubilee Fund, the Canadian Worker Cooperative Federation’s Tenacity Fund, and the Canadian Alternative Investment Cooperative (CAIC).

The co-op hopes to launch an investment share offering that will qualify for the provincial Community Enterprise Tax Credits Program. This program allows private investors to claim a 30% provincial income tax credit on investments into an approved enterprise. To create public investment shares, Neechi must file an Offering Memorandum with the Manitoba Securities Commission and develop a plan to market the shares.

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\(^8\) The Jubilee Fund Inc. is an interfaith community loan fund that provides loan guarantees and/or equity to economic initiatives that promote self-reliance, human dignity and a better quality of life.

\(^9\) Bill Loewan is a CED motivated private investor who loaned the cooperative $40,000 in 1996.

\(^10\) The Collaboration Co-operative retains a pool of specialists who assist developing cooperatives and provide management support services to Neechi and to the Northern Star Worker Co-op (makers of star blankets).
Mission Accomplished?

At Neechi Foods, the social mission is close to the heart of the workers who own and operate the store every day. In prior years, their commitment was demonstrated in their willingness to vote themselves wage cuts and to grind through many challenges. Although it has been a difficult process, they have met their main social objectives: secure employment in a safe and secure environment, providing quality food at affordable prices. The proposed expansion will contribute to neighbourhood revitalization.

Neechi Foods – Enterprise Development Path

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<th>MATURITY</th>
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<tr>
<td>CED planning</td>
<td>$300,000 capital launch fund:</td>
<td>Economy crashes, sales stalled, 25% wage cuts</td>
<td>$24,000 in average annual profits over past 3 years</td>
<td>Future plans: • purchase new building. • new niche markets and value added specialty products</td>
</tr>
<tr>
<td>Food store pilot project</td>
<td>• $100,000 mortgage</td>
<td>Private loan $40,000</td>
<td>$40,000 loan to equity conversion</td>
<td></td>
</tr>
<tr>
<td>Housing Co-op loan of $2,000</td>
<td>• $150,000 capital grants</td>
<td>Periodic commercial loans</td>
<td>Wages boosted</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• $40,000 private loans &amp; grants</td>
<td>Breakeven operations</td>
<td>Assets badly deteriorated, require repair or replacement</td>
<td></td>
</tr>
<tr>
<td></td>
<td>MCC loan guarantee $20,000</td>
<td>Debt:Equity 2:1</td>
<td>Debt:Equity 1:2</td>
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CASE STUDY: TALL GRASS PRAIRIE BREAD COMPANY

Ownership structure: private corporation

Industry: neighbourhood bakery, character mall bakery & deli

Formation: formed in September 1990

Governance: three of the founders serve as directors (as well as part of the management team) and outside advisors as needed.

Social objectives:
- product integrity – organic ingredients
- living wage for the workers
- increase returns to producers

Seed Stage

In September 1990, a group of friends decided to put their social justice values into action. The idea of a Tall Grass Prairie bakery grew out of a church meeting that fall. Lyle Barkman’s commitment began with the simple statement, “I guess I could help out with the baking.” Four others stepped forward and the company was born.

Tall Grass formed around a set of core values that focused on food security and fair wages. Their initial aims were to inject money into the rural economy and to create a connection between urban dwellers and their food source. They wanted to produce a “product with integrity” made from organic ingredients, and provide just wages to the producers and workers. In the early years they were not particularly focused on making money. That came later.

Stuart McLean told the Tall Grass story on CBC Radio’s Vinyl Cafe on June 10th, 2006.

They found one (a bakery) for sale and figured they needed about $40,000 to get going. They went to the bank, and explained they wanted to sell bread at $2 a loaf rather than the going rate of 50 cents. They said they figured if you explained to people that you were charging more so you could pay farmers more, people would be happy to pay the extra. The bank told them this was absurd. The bank said that wasn’t the way the world worked. So they got money from friends. Some low interest loans, some no interest loans. They promised to pay them back if and when they could.

Start-up/Launch

They purchased an existing bakery out of bankruptcy for $35,000 in 1990. It was operating in a run down rental property in the Wolseley district, one of the oldest neighbourhoods in the city, affectionately known as Winnipeg’s granola belt.
Startup/launch funds came in the form of 'love money' from the church community, the local neighbourhood and personal friends. A number of small investors took a leap of faith, providing loans of $3,000 to $5,000 each. By 1999, those original investors had been paid out on whatever terms they wished. Many of the loans were forgiven. This formed the initial equity base for the firm.

Start-up/Survival

They had planned to run a small enterprise that would support 3 or 4 families, but were taken by surprise by the immediate success. “It took off on a completely different scale than we had anticipated,” says Barkman, “We met our first year projections within the first 6 weeks and we burnt out our first mixer within nine months. Everything was turned on its head.”

Over the years, the company financed the purchase of bakery equipment through a number of small loans with Assiniboine Credit Union (ACU), where they held their operating bank accounts. These were usually in the $5,000 range and were secured with personal guarantees by the owners.

Growth/Profitability

In 1994, Tall Grass needed to purchase the property that housed the bakery operation, to secure its operational base. The property included a duplex that generated rental income. With the required down payment in hand, three years of operations behind them, and a tangible real estate asset with its own secure revenue stream as collateral, they went in search of a mortgage. They were refused by several urban banks and credit unions who judged Tall Grass as either too risky, or outside their scope of business.

They turned to the Steinbach Credit Union (SCU), the largest credit union in Manitoba. Perhaps the SCU was more receptive to the Tall Grass environmental and rural development agendas due to its Mennonite roots in the rural community or perhaps they just saw it as a solid business opportunity. In any case, SCU approved the mortgage. “We got the feeling that they wanted our business,” says Barkman, “We were treated like a regular customer.”

They also received a warmer reception at ACU in 1998 when they first approached them to refinance the mortgage and consolidate their loans. (ACU had turned down their first mortgage request.) This coincided with a major change in corporate direction at ACU that Barkman refers to as “the greening of ACU.” The new corporate philosophy included support for community and environmentally focused enterprises that meshed with the Tall Grass social mandate. “This time ACU was able to stretch for us, and work around situations that other lenders would not touch.”

In 2002, they applied to ACU for an operating line of credit to support the working capital requirements of the growing business. Tall Grass had just opened its second retail location and catering operation. They set up a line of credit for each location, for a combined total of $75,000, secured by personal guarantees from the three owners.
With growth, came greater financial exposure and risk. The management group decided to hire a general manager that would focus more on the dollars and cents of the operation. Cash flow improved and so did the overall financial health of the company which in turn, reduced their reliance on the line of credit. It was another very important factor in the success of the company.

*Maturity*

After seventeen years in business, Tall Grass is a renowned Winnipeg institution. The company has flourished, drawing upon a loyal customer base, strong relationships with its suppliers and a committed staff of about 45 employees. They operate three retail outlets in Winnipeg, one in Wolseley and two at The Forks, and a growing catering and distribution arm supplying distinctive, high quality products to a loyal customer base at premium prices. It is particularly famous for its jumbo whole wheat cinnamon buns.

At the time of writing in early 2008, they are contemplating a $500,000 expansion to double production capacity of the bakery operations and expand the catering business and food distribution network. With a strong balance sheet and solid cash flow, Tall Grass no longer faces the earlier problems of access to financing. “With our cash flow, we can get the financing that we need now,” says Barkman.

A new set of challenges faces the company in the early 21st century. The three owners and managers are in their 50s, 60s and 70s now and in time, a new generation of leaders will need to step forward if the company is to carry on. The question is whether the company will be able to sustain that commitment to the social mission as it faces the challenge of leadership succession.

*Mission Accomplished?*

Along with the increased attention on the financial bottom line, Tall Grass strives to remain true to its original social mandate.

- The commitment to fair wage employment practices continues. The company pays above average wages for its industry and provides full medical and dental benefits. Most of the employees live in the neighbourhood and the company often employs disadvantaged workers.
- It has maintained the original commitment to the product. All the flour comes from organic grain and the whole grains are stone milled within the bakery plant.
- Relationships with the producer/suppliers remain strong. Tall Grass pays the organic premium for its inputs. They were part of the formative group behind the national organic foods certification standards.

Although the company does not follow a formal SROI (Social Return on Investment) reporting and analysis system, they do continue an informal process of balancing social and financial goals to help keep them on track with the original social goals.
### Tall Grass Prairie Bread Company - Enterprise Development Path

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<tbody>
<tr>
<td>Informal bread co-op started in church basement</td>
<td>Bakery business purchased, $35,000</td>
<td>1994, property purchase, mortgage with cash down payment</td>
<td>Greater attention to financial affairs. Cash flow improves</td>
<td>Distribution company expansion plan</td>
</tr>
<tr>
<td>$40,000 launch capital raised from neighbourhood investors</td>
<td>Series of LOC approvals and small equipment loans, secured by personal guarantees, starting in the late 1990's</td>
<td>Remortgaged property and consolidated loans</td>
<td>$500,000 capital expansion planned</td>
<td></td>
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<td></td>
<td></td>
<td>$75,000 operating line of credit</td>
<td>Succession challenges</td>
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</table>
COSTS AND BENEFITS

Returning to Gould’s (2006) contention that the social mission goals impose some “inherent disadvantages … that cannot be ignored” (pp.12,13.), one wonders whether the social mission delivers any offsetting advantages. The question was posed to the 4 social entrepreneurs in this way:

“Does promoting social/environmental values help your business grow and acquire funding?”

The answer: “It depends.”

Both Inner City Renovation and Neechi Foods have experienced benefits on the financing side. Virtually all of Neechi’s financing has come from socially motivated individuals and organizations.

Donkervoort reports that the social mandate does offer some unique opportunities to help finance the extra costs associated with the ICR human resource objectives. The company has been very skillful and fortunate in tapping those funds. For example, when the United Way decided to experiment with support to social enterprises, ICR was chosen as a test case. It received about $45,000 in 2006 and 2007 to assist with non-operational expenses such as the social and life skills support. ICR hopes to become part of the United Way annual program.

The Cooperators insurance company has been a strong supporter of both ICR and Neechi as part of their commitment to corporate social responsibility. In addition to providing the performance bond for ICR, The Co-operators has granted them $20,000 per year to assist with the extra costs attached to the social goals. They also helped Neechi Foods when their delivery van was vandalized and written off.

Socially motivated finance providers like Assiniboine Credit Union (ACU) and the Jubilee Fund at the provincial level, the Canadian Alternative Investment Co-operative (CAIC) at the national level, and others across the country\(^1\), make it their business to support social enterprises across the country. While the social mission does not guarantee financing, it does get the proposal in the door, says Rothney, who also serves as manager of Community Economic Development at ACU. “There are rules and guidelines that have to be met, but when a loan is turned down, it is usually because the people involved do not believe it will work. Generally speaking, if the plan is a good one and the finance request is reasonable, it should get funded.”

The effect of the social mission is more variable on the marketing side.

In the beginning there was an expectation that the social mission would help drive revenues for Neechi Foods, says Rothney. In reality the mission has produced significant benefit in organizational sales (schools, group homes, L.I.T.E.\(^2\), etc.).

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\(^1\) Similar socially motivated financing services are available in other communities through organizations like the Affinity Credit Union in Saskatoon, and for specific sectors, such as the Tenacity Fund that provides financing to worker cooperatives across the country.

\(^2\) L.I.T.E. is a Winnipeg, CED charity that, among other things, purchases goods for Cheer Board hampers from Neechi.
However, the mission has not had as much impact on individual customer sales, which are driven mainly by price, product, service and convenience.

The social/environmental mission has generally worked against the Natural Cycleworks courier business, says Geisel. It seems that most courier customers are only interested in buying the service. Price and service are the drivers here. Mention of the social and environmental mission turns some potential customers away, so they no longer talk about the mission in their courier business sales promotions. It’s a different story in the bike shop. The environmental mission does attract a loyal clientele of like minded, environmentally conscious bike enthusiasts. Geisel believes the mission will be integral to the value proposition of the proposed parts distribution enterprise as well.

The social mission is a big reason behind the Tall Grass success in the market place. “We do speak about the social mission,” says Barkman, “and our customers are quite willing to pay a higher price for their products to support the values of organic ingredients, a fair return to the farm producers and great taste.”

CONCLUSION

Mission based enterprise offers potential as a vehicle to advance certain social objectives within a market context. However this model presents considerable challenges on a number of fronts.

Securing adequate and appropriate financing to support the enterprise development is one of those challenges. Finance providers have developed specialized products and services that address some of the needs of the emerging SE sector. Many of these resources focus on debt financing which is usually more available and easy to access than equity. This is just as true for traditional for profit enterprises as it is for social enterprises, especially in the early stages. Access to equity financing to grow the enterprise to a sustainable level is a great challenge for social enterprise and an area of great need. Some innovative equity finance models are being investigated and it is hoped that more solutions will arise to address the specific requirements of this sector.

Social entrepreneurs face all of the management and finance challenges that traditional for profit enterprises struggle with, along with the additional demands that flow from the social/environmental objectives of the mission. They must adapt the best appropriate practices from both worlds to satisfy the objectives of the blended mission. It is a formidable task requiring exceptional leadership skill, along with patience and a great deal of support from the community that the enterprise is striving to serve.
REFERENCES


Regional Partner Organizations

UNIVERSITY OF SASKATCHawan
Centre for the Study of Co-operatives

Community-University Institute
for Social Research

Community Economic and Social Development Unit
Algoma University College

Winnipeg Inner-City Research Alliance

Project Funding

Social Sciences and Humanities Research Council of Canada
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