Emerging finance options for social enterprises commerce essay

Business

\n[toc title="Table of Contents"]\n

\n \t

\n[/toc]\n \nWhile options for funding have traditionally been scarcer for businesses that focus on social or environmental impact, new and innovative funding solutions are surfacing and gaining momentum in recent years. Despite focusing on a social agenda, social enterprises also need to achieve financial sustainability. This requires a garnering of resources in terms of financial, physical and human resources. While regular entrepreneurs can take their business and financial plans to their local business bank and obtain a loan, or convince private investors to provide them with the start-up capital by giving them thorough financial plans, it’s less clear-cut for social enterprises. For regular venture capitalists, the focus is still on profits and returns, and demonstrating social impact is not enough. Similarly, very few banks are willing to lend to ventures that have unconventional business models without high interest rates or risky personal guarantees. At the same time, ‘ for profit’ social enterprises have been excluded from foundation and donation-based funding sources, although this is gradually changing with new legislation to assist new hybrid models. A new breed of social investors is emerging. From angel investors and social venture capital firms to impact investors, philanthropic investment funds and patient capital, there are options available for social enterprises that can demonstrate social impact and scalability. In addition, technology is changing the funding landscape with online platforms emerging to connect entrepreneurs with individual investors within the community, whose small change can add up to large investment sums. Social impact does not always have to come at the cost of profits. With the potential for long-term impact, social entrepreneurship actually presents a highly profitable business opportunity for entrepreneurs and an investment opportunity for venture capitalists.

The rise of social entrepreneurship

Nonprofit organizations enjoyed the benefits of the 1990s economic boom which triggered increased funds and programs in the philanthropy sector allowing it to thrive. However, recently the global recession has taken its toll on the nonprofit sector. At the same time, there is much discussion as to whether traditional philanthropy, charity, grants, donations and aid can actually create global social change. Many think not, hence the increased interest in applying businesslike ways of thinking to the social sector. However this new breed of social business owners, whilst focusing on their social mission, must also develop creative ways of mobilising financial resources and eventually become sustainable. ' You can raise money for a charity and you can obviously raise money for market rate financial returns, but it is hard to raise money for social ventures/enterprises ' stuck in the middle''(Mirjam Schoning, Director, Schwab Foundation for Social Entrepreneurship). Changes to funding models are emerging as both the private and social sector are realizing the impact that the latest social enterprises are having on the global community. There is now an escalating demand for new funding options to meet the finance needs of a new generation of entrepreneurs graduating from business schools with a social perspective and a desire for long-term impact. Social Entrepreneurship conferences are always the best-attended events for students of leading business schools and this trend is likely to continue as young people are becoming increasingly connected and socially aware in a globalised world.

Social venture capital firms and investment funds

In recent years there has been an increase in the number of social venture capitalists actually seeking out enterprises to invest in - ones that work towards social goals. They are funding and influencing a new business model where social impact, accountability and profit intersect. Funds from these firms are usually referred to as ‘ patient capital’ as investors are willing to wait to see returns on the business and they usually see social impact results equally important to profits. Firms are also just as interested in the social business’s social mission and any proposed change to this has to be run by the venture capital firm. However, while social investors have been happy to invest in start-up capital, there has been a reluctance to commit to expansion capital, despite growth being a vital factor in the sustainability of an enterprise. Financing the growth of operations to achieve major scale is currently the biggest challenge facing social entrepreneurs. Certain investment funds are bending the rules of traditional lending. Root Capital is a nonprofit investment fund that can lend up to $750, 000 directly to cooperatives in the developing world, allowing them to use their orders as collateral, and with a low 9 percent interest rate. A successful and widely publicised social venture capital firm that is pioneering socially responsible investing is Underdog Ventures in the US. According to their website they have developed a new model of customised community venture capital funds, combined with a model of customised philanthropy. Underdog Ventures partners with a group of investors committed to financial, community and environmental results. They create innovative and customised investments to meet the specific needs of each of our investors, each of whom has a dedicated fund that invests in their areas of interest. Social Venture funds such as these have a different model to regular venture capital firms which protect the rights of the private shareholder, in that they prioritise investor values for the benefit of all stakeholders, from beneficiaries to investors. The Acumen Fund is a more creative take on the traditional investment fund and was developed out of the need to combine the efficiency and scale of the markets with the social impact of pure philanthropy in order to tackle poverty. The fund provides ' patient capital' which they define as the debt or equity investment characterised as having long term horizons, risk-tolerance, a goal of maximizing social rather than financial returns, providing management support to help new business models, and the flexibility to seek partnerships with governments and corporations through subsidy and co-investment. Venture Philanthropy firms are combining long-term grants to non-profit social businesses with management assistance. Ashoka, The Skoll Foundation and Venture Philanthropy Partners are some of the most well known among an increasing number of such firms. Venture Philanthropy Partners is another, which aims to invest strategically instead of just granting generously, by supporting their financial investments with support, expertise and personal contacts. Omidyar Network is a standout example of a unique philanthropic investment firm that is changing the way philanthropy and investment come together. It invests in high-growth entrepreneurs that provide low-cost products and services to underserved populations and help drive economic activity. They offer what they call ' flexible capital', meaning they invest financial and human resources in both for-profit and nonprofit social ventures combining grants and for-profit investments, with societal value being the bottom line.

Banks and the Finance Industry

Following the recent success of social venture funds, banks are starting to see the potential in lending to companies with sustainable practices. New Resource Bank is a community bank in San Francisco that lends to businesses geared towards environmental and sustainable businesses and was able to increase its assets from $25million in 2006 to $130million in 2008. Community Development Banks can also make loans to social businesses through earmarked government supported funds. New commercial microcredit funds have emerged recently as the first example of the finance industry profitably connecting investors with social business opportunities. This is promising as it's sustainable and scalable for both the finance institution and the social business receiving the investment.

Government partnerships

Governments are also being urged to look at innovative ways of improving social welfare and are tapping into the private sector in order to do so. Public-private social innovation funds are the latest methods of advancing social entrepreneurship by leveraging taxpayer dollars with private funds. In mid 2010 the Obama administration established a Social Innovation Fund (SIF) providing $50m of public money matched by $74m from philanthropic foundations, to nonprofit organizations. It is part of a wider plan under the banner of ‘ social innovation’ to promote new partnerships of government, private capital, social entrepreneurs and the public. Government involvement is helping to speed up the growth of social innovations, and at the same time politicians are increasingly interested in the fresh ideas that build upon their public services, which aren’t sustainable due to the fast deterioration of government’s finances. The British government has been working with social innovation funds and paying attention to non-profits and social entrepreneurs for over a decade. The idea of the public listed company gave social entrepreneurs in Britain greater flexibility in being able to scale up social innovations using a profit motive. Similarly, the US has legislated the B-corp model which is a hybrid of a for-profit company and a nonprofit organization. Such flexibility and lack of restraint should aid innovation and bridge the two sectors, leveraging the positive elements of each. A ‘ B Corporation’ is a business that has been certified after meeting comprehensive and transparent social and environmental performance standards and higher legal accountability standards. It was a result of new legislation in the state of Pennsylvania in the US that is changing the structure of business by allowing directors to make business decisions based on non-financial (social) interests. Having such status can help entrepreneurs signal to social investors that they are in business to solve social problems. It also demonstrates a commitment to sustainability, enforces accountability in that the business has already been vetted by a third party, puts the business in the centre of a closed investing community. The trend towards public-private partnership models will hopefully pave the way for more effective partnerships to improve social and public services.

Innovations in resource mobilization and online sources

In addition to those discussed so far, the Schwab Foundation for Social Entrepreneurship also lists the following funding strategies: Selling products and services: An export oriented approach where the products and services are mission related and the beneficiary is the customerIn-kind resources: Goods for programs, technical assistance and expertise and volunteers. Fees/cost recovering: The use of membership or licensing fees. According to the Schwab Foundation, social entrepreneurs are also trying new models for expanding that don’t require significant amounts of capital or human resources such franchising, decentralization, working with volunteers. Decentralization refers to various nodes of the business being responsible for raising its own funds – similar to a franchise model but more scope for local adaptions. These new funding models create greater sustainability in the long-term. With recent online innovations, social entrepreneurs are now harnessing the power of the internet and social networks. Crowdfunding is the latest trend to attract community investment dollars and help individuals play a role in social change. They are web-based platforms that connect entrepreneurs solving big global challenges, with micro-investments provided by individuals. Established just this year, 33needs is a powerful example of the impact that this new trend towards crowdfunding web application is having. Similarly Profounder works on the same principle, helping businesses get their products to market through community funds. In addition, the site creates a support base for the business and gives guidance on creating a fundraising pitch, managing investments and returns and legal issues.

Conclusion

This new breed of social venture capital firms and other innovative funding sources are providing financial solutions for unconventional business models that are recreating hybrid nonprofit/for-profit enterprises. Just as traditional banks started to see the financial potential of the microfinance industry in the 80s and 90s, so too is there an opportunity for the financial industry to now do more and create a solution The social business sector is continuing to grow at a rapid rate and this is presenting the for-profit finance sector with an enormous profit-generating opportunity, as well as the chance to be involved in lasting social change. Social investors are taking a different approach to social business and urging their portfolio companies to maintain their social mission as they grow. They often take a strong interest in the mission itself and new ideas for social good rather than just profits. Social entrepreneurs must also be able to measure and demonstrate their social impact. Social investors are increasingly allocating money to the accountable, high impact social change organizations. While for profit businesses measure profit, the social sector lacks a similar measurement. Increased competition for scarcer funds following the economic downturn means that there is even greater pressure for more accountability and transparency, and social enterprises will be pushed to do more with fewer resources. The expansion of social entrepreneurship is building a strong appetite for investment and ushering in a new era of innovative funding models. At the same time social entrepreneurs are being encouraged to be profitable and sustainable while also creating long-term social impact.