

INNOVATIVE WAYS OF FINANCING SOCIAL ENTREPRENEURSHIP

Mihai Sebea, PhD
Romanian-American University
sebea.mihai@profesor.rau.ro

Abstract:

Social entrepreneurship is not new, but it is getting momentum. Social innovation that could be delivered by social enterprises should be seen as a way to improve the welfare of communities and to foster sustainable growth. This is becoming more important with the financial and economic crisis dramatically affecting our world. Even if it is not new, the concept of social entrepreneurship is still searching for the proper definition and boundaries. Going deeper, if we look at the issue of financing opportunities for social enterprises we realise that there is a lack of literature regarding it. Some of the financing routes that are traditionally available to businesses are also available for social entrepreneurs, with extra challenges for the latest. What is interesting is that there are some advantages for social entrepreneurs, as they could use new ways of financing that might not be available for other businesses. This paper is addressing few innovative ways to finance social enterprises, taking account of new trends and developments that can shape social entrepreneurship.

Keywords: social enterprise, social entrepreneurship, financing entrepreneurship, social innovation

Introduction

It is widely accepted that entrepreneurship represents a core factor for economic development. What are social entrepreneurs bringing more, is that their initiatives are focused on creating social values, addressing the issue of profit as a secondary goal. It is interesting to acknowledge that running business can overlap with a passionate way to address a social problem.

Social entrepreneurship is increasingly challenging the traditional way of doing business, and social enterprises are developing around the world, even if in statistical term they are still a niche form of business (European Commission/OECD, 2103)

According to the European Commission, social-economy (social enterprises, mutuals, co-operatives and associations) represent 2 million undertakings (10% of all European businesses) and employ over 11 million paid employees (the equivalent of 6% of the EU's working population).¹ Social enterprises are active in a wide spectrum of fields including education, housing, culture and the arts, tourism, banking, insurance, agriculture, craft, various commercial services, and health and social services, etc.

¹ <http://ec.europa.eu/enterprise/policies/sme/promoting-entrepreneurship/social-economy>

It is thought that social initiatives can fill the gap between social needs and public capacity to solve them. Even though they cannot solve all the problems, it is clear that they represent an important tool that can increase in importance. Thus, the issue of ways to financing social enterprises is a crucial one.

The paper has a special focus on EU' developments.

Conceptual framework

The concepts of social entrepreneurship and social enterprise are getting increased popularity. American (and not only) universities are teaching courses about the subject, journalist and philanthropist are frequently referring to them. But how can we define the concepts? It seems there is no universally accepted definition and sometimes confusion, misunderstanding or uncertainty occurs.

This is why the starting point for this analyze regards the way(s) of defining social entrepreneurship and social enterprise. One of the main issues is that when speaking about what is a social initiative there are some practical implications: who benefits from state aid? Who can use special services support? What kind of entities can benefit from dedicated ways of financing? Definitions that are becoming official (and even regulatory) are very relevant from this point of view.

David Bornstein, one of the leading authors in the field, sees the social entrepreneur like *“a person who has both a powerful idea to cause a positive social change and the creativity, skills, determination and drive to transform that idea into reality. Social entrepreneurs combine the savvy, opportunism, optimism and resourcefulness of business entrepreneurs, but they devote themselves to pursuing social change or “social profit,” rather than financial profit. Behind all innovative business, there are entrepreneurs – Individuals who possess the foresight, belief and boldness to build something new. The same holds for social change. Behind almost all important social innovations are social entrepreneurs – people with new ideas for solving problems, who build new kinds of organizations to implement those ideas, who will not take ‘no’ for an answer, and who will not give up until they have spread their ideas as far as they possibly can”*. (Bornstein, 2004)

Ashoka defines social entrepreneurs like: *“individuals with innovative solutions to society’s most pressing social problems. They are ambitious and persistent, tackling major social issues and offering new ideas for wide-scale change. Rather than leaving societal needs to the government or business sectors, social entrepreneurs find what is not working and solve the problem by changing the system, spreading the solution, and persuading entire societies to move in different directions (...) They are visionaries, but also realists, and are ultimately concerned with the practical implementation of their vision above all else”* (www.ashoka.org)

More recently, Abu-Saifan offers the following definition: *“the social entrepreneur is a mission driven individual who uses a set of entrepreneurial behaviours to deliver a social value to the less privileged, all through an entrepreneurially oriented entity that is financially independent, self-sufficient, or sustainable”* (Abu-Saifan, 2012)

As regarding the social enterprise concept, we present “official” definitions:

OECD defines a social enterprise as *“any private activity conducted in the public interest, organised with an entrepreneurial strategy, but whose main purpose is not the maximisation of profit but*

the attainment of certain economic and social goals, and which has the capacity for bringing innovative solutions to the problems of social exclusion and unemployment”

The **European Commission** defines the social enterprise like:

An undertaking, regardless of its legal form, which:

- ▶ *has as its primary objective the achievement of measurable, positive social impacts rather than generating profit for its owners, members and shareholders*
- ▶ *uses its profits first and foremost to achieve its primary objective*
- ▶ *is managed in an entrepreneurial, accountable and transparent way, in particular by involving workers, customers and/or stakeholders affected by its business activities.*

According to a recent G8 forum release (G8 Social Impact Investment Forum – 6 June 2013), “social enterprises are businesses that tackle social or environmental problems and work in communities to improve people’s lives. Social enterprises can include charitable non-profits or businesses that make money. The majority of social enterprises reinvest their profits in the communities they work in”.

The national body for social enterprises in UK – **Social Enterprise UK** applies the following definition: “a social enterprise is a business that trades for a social and/or environmental purpose. It will have a clear sense of its ‘social mission’: which means it will know what difference it is trying to make, who it aims to help, and how it plans to do it. It will bring in most or all of its income through selling goods or services. And it will also have clear rules about what it does with its profits, reinvesting these to further the ‘social mission’”.

Social enterprises come in many shapes and sizes from large national and international businesses to small community based enterprises, But they all:

- ▶ Are businesses that aim to generate their income by selling goods and services, rather than through grants and donations
- ▶ Are set up to specifically make a difference
- ▶ Reinvest the profits they make in their social mission

According to **Social Enterprise UK**, social enterprises should:

- ▶ Have a clear social and/or environmental mission set out in their governing documents
- ▶ Generate the majority of their income through trade
- ▶ Reinvest the majority of their profits
- ▶ Be autonomous of state
- ▶ Be majority controlled in the interests of the social mission
- ▶ Be accountable and transparent

Developments towards new ways of financing social initiative

Innovation in financing the social sector is based on new developments that are redefining the access to finance for social entrepreneurs.

Impact investing concept. Considered to be a term coined by a group of investors convened by the Rockefeller Foundation in 2007, it refers to a broad array of profit

seeking investment strategies that generates social and environmental good as well as strong financial return. (Cleveland, 2013). Thus, the concept is overlapping with the purpose of a social enterprise. It is agreed by the Rockefeller Foundation itself that this new way to solve social problems is able to providing more money than all the philanthropies and governments have at their disposal to make a significant impact on improving the lives of all the poor and vulnerable people in the world. However, it is important to note that impact investors vary widely in character – from individuals to institutions across sectors.

Social media. First of all, social media represents a mandatory tool to be used by social enterprises to create the desired impact for their whole project. Most important, the rise of connectivity is offering entrepreneurs powerful tools to reach different types of investors. LinkedIn for instance is a professional network of over 225 million people, its technology allowing members to find partners that fit to their proposal. Besides well-known social media networks, there are some that are designed for professionals in financial industry.

Social media allows entrepreneurs to get in contact with their supporters and raise funds. There are more and more fundraising opportunities and networks of microdonations that are changing the capital market for social enterprises. Social media paved the way to the new trend of “*crowdfunding*”.

Crisis as an opportunity? – The financial and economic crisis that occurred in 2007-2008, dramatically changed the world and the financial markets. Big corporations were hit by it, some of them being saved by the governments. Even if the social enterprises are not immune, their implied strategies that are focused on social values, sustainability and long run view is opposite to one of the crisis cause: greed for profit. It is stated by the European Commission President that “*the financial and economic crisis makes creativity and innovation in general, and social innovation in particular even more important to foster sustainable growth, secure jobs and boost competitiveness*” (European Commission, 2012)

Moreover, ***budgetary constraints***, especially in Europe, as well as the question of EU social model could bring a reorientation on the way the public money are spent. Social innovation can bring public budget savings by offering new and more efficient ways of solving social problems. This is reflected under the new EU’s programmes 2014-2020 that put an emphasis on innovation and social economy as well.

Regarding the financial sector point of view, as financial institutions lost public confidence, there could be a shift to a new business model that includes social purposes besides profit. On a deeper view, social banks could get momentum.

Partnerships. It is known that one of the core concept of social enterprises are that they put the social interest before profit. Working for a social purpose means that you address a problem that could be under the “radar” of other stakeholders as well, creating at least one reason for partnerships.

Corporations, nonprofits and governmental entities seem to collaborate to a degree never seen before, moving to what tends to become the new norm of business. Within a

cross-sector partnership, corporations are bringing resources, nonprofits are offering credibility and a very good image in the eyes of the public, and the authorities could offer logistic support, but most important contributions is related to the regulatory power. (see Cleveland, 2013)

New corporate view about CSR? One issue that maybe needs a further analyse, is related to multinational corporations' attitude, as they could be more aware of their social involvement. Some of the questions are: are they more willing to address this issue based on their own activity, or they are looking to finance social initiatives, and to be part of them? Could there be more incentives to corporations to invest in/finance social enterprises?

The issue of access to finance

As it is known conventional business financing range from using own funds to external financing. The latter splits in: grants, private equity (venture capital & business angels), bank loans, IPO and not last, crowdfunding/crowdfinancing as an innovative tool.

If we look at the issue of access to finance for SME's in Europe, the latest ECB's report shows that "Access to finance" is on average the second most pressing problem, after "Finding customers", but before issues like "Competition", "Cost of production", "Availability of skilled staff or experienced managers", "Regulation". (European Central Bank, April 2013)

On the high side, 38% of the SMEs in Greece, 25% in Spain, 24% in Ireland and 21% in Portugal mentioned "Access to finance" as the most pressing problem, compared to 8% of the SMEs in Germany and Austria on the low side. At the euro area level, on balance, 5% of the SMEs reported an increase in their need (demand) for bank loans and 12% reported an increased need for bank overdrafts.

Regarding the availability of external financing, the report shows the SMEs were referring to:

- worsening of the general economic outlook
- reporting a worsening in their firm-specific outlook
- deterioration of banks' willingness to provide a loan

The main problems related to terms and conditions of bank loan reported by SME's were:

- increase in interest rates
- increase in other costs of financing
- increase in collateral requirements,

Moreover, it is showed that equity financing was severely affected by the financial crisis.

If we look at the social enterprises difficulties, it seems that in most OECD countries, social enterprises have difficulty obtaining access to credit (considering the fact that one of the key financial product used the most mainstream enterprises is bank loans).

Traditional institution generally refuses to lend SE (do not meet their established client criteria; are not seen as offering sufficient guarantees). (European Commission/OECD, 2013)

What is special and innovative in financing social enterprises?

In that kind of an environment, as the social enterprises are not always qualifying for finance under traditional methods/institutions they should be seek for new partners and innovative ways of financing their initiative. They are based on the fact that innovation is arising on the funding supply entities and methods as well. ***It is important to note that social enterprises have the chance to use dedicated and specific channels that are not available to traditional businesses.***

Grants (direct and indirect opportunities). As traditional businesses do, social enterprises can apply to public grants awarded to reach specific objectives. What is important for SEs in Europe is to be aware that they could have more opportunities than traditional business, as social innovation seems to be more present as an issue under EU's new programs 2014-2020.² Indirect opportunities refers to the fact that social enterprises could benefit of different structures launched under public grants that are offering support to boosting innovation and investment readiness.

Funds focused on innovation could also be a target for social entrepreneurs. In this regard, they could look at those that are investing mainly in service innovation, delivered either by the public or social sector like: Young Foundation and the NHS Regional Innovation Funds in the UK, European Union's Equal Programme. In US notable examples include: Investing in Innovation Fund for Education, the Social Innovation Fund or the Race to Top Fund.

Institutional Investors are represented by different type of traditional funds such as pension or mutual funds, insurance companies or traditional banks which manage large portfolio. However, some of them are focusing on social impact:

Commercial investment funds – funds that prioritize financial returns and also seek to achieve social impact (Bridge Ventures – UK, PhiTrust-France, BonVenture, Germany)

Social investment funds – funds that prioritize social impact but also seek a financial return for investors (CAF Venturesome, Social Investments Business – UK, Fondazione CRT – Italy, Hellenic Social Investment Fund - Greece)

Social banks are specialized in the social sector and mainly offering secured loans. Profit is one of the objectives, but not the main one. They are concerned about the

² The 2020 EU's budget represents significant support for social innovation at European level. Moreover there are proposals to integrate social innovation family of funds as well as to create a dedicated European Social Innovation Fund (European Commission, 2012)

community, about contributing to the well-being of the masses ensuring that their activity is in line with the broader goals of the society. Social banks would seek to closely understand the requirements of the customers and develop products that are best suited to their needs. (Chakrabarty, 2012). Relevant examples are Banca Prossima – Italy, Credit Cooperatif – France, Charity Bank - UK).

Venture philanthropy. The concept replicate the venture capital model into a social investment strategy that implies blended returns: financial revenues and social benefits. In Europe EVPA – European Venture Philanthropy Association, represents different venture philanthropist involved in financing social initiatives. Examples of Venture Philanthropy Funds are: Impetus Trust, Social Business Trust, The Foundation for Social Entrepreneurs, Esmée Fairbairn Foundation – UK, d.o.b foundation – Netherlands.

Corporate financing. Could become an important route of financing social initiatives if entrepreneurs are attracting corporations as investors in their project, as a way for CSR. For instance, in Romania Unicredit Business Integrated Solution & NESsT launched 3 projects of Social Enterprises (in July 2013) and OMV PETROM is financing different projects with social impact based on competition).

Crowdfinancing. Seen as an innovative solution mainly for traditional businesses, crowdfinancing is an opportunity for social and humanitarian projects as well (more than 500 platforms in total). Kiva, JustGiving or Babyloan are examples of platform that can put “crowd investors” face to face to social entrepreneurs.

Social (impact) bonds (‘pay for success’). They represent a new mechanism to harnessing private capital to address and to solve some of the social ‘ills’. The scheme is based on four types of parties: the government that decides what problems needs to be solved, the intermediary that is the issuer of the bond(s), independent investors that are offering private capital and a non-profit service provider. If the project reaches its objectives, the government repays the investors with returns based on savings that governments accrue due to the project’s success (for more details see Harvard Magazine, July-August 2013).

On a personal view, I am not the advocate of awarding grants from public money to solve different social problems, on continuous basis. There are (at least) three reasons for that:

- 1 - Grants are spent some times without enough strictness or efficiency, the implied entities not realising the ‘value of money’ and the ‘value for money’ – “easy come, easy go”...;
- 2 - Awarding grants on continuous basis to solve a problem can create dependency;
- 3 - An indirect financial support to social initiative could be more efficient and sustainable for different types of communities, creating the long run way of support for innovative approach for entrepreneurs.

Moreover, it is desirable that solutions for social problems should not come from just one entity, but more desirable from partnerships at different levels (local, regional, centre) and different types of entities (public, NGO's, private) looking for the mutual interest.

The idea of supporting a private initiative that is profit oriented but is looking to solve a social problem, a local community difficulty or to be environmental friendly on one hand, and can save a lot of public money, on another hand could be more effective. From another point of view, that kind of initiative has strong social principles, is long run and wide range oriented, not seeing profit as *raison d'être*. That means sustainability for the initiative as well as for its results offered to society. Small margin, but sustainable profits could be interested by investors or lenders (including banks).

The traditional banks should put more emphasis on tailored offers to SEs. For instance in UK there are "Community banking" products available. In July 2013, the Cooperative Bank launched the Social Enterprise Directplus account. It's specifically designed for community interest companies (CICs) set up with social or environmental value as their primary goal and offers a number of **free banking facilities**.

The main reason to launch this new product was that Social Enterprise UK's State of the Sector report 2013 showed the status of social enterprises, with more of them experiencing an increase in turnover compared to mainstream SMEs and more seeking finance.³

Conclusion

The first conclusion (and maybe the most important) is that there are more types of opportunities to finance a social initiative than a traditional business. There are dedicated, specific and innovative ways of financing a social enterprise. Social entrepreneurs should take advantage of them!

As local regional or central authorities may be involved in financing schemes, another conclusion is that innovation in social financing could bring savings to local, regional and central budgets. The authorities can move the central point from public spending or public procurement to solve a social problem, to supporting social enterprises that can address that problem under a 'for profit (social) initiative' in which less public money are spent.

The third conclusion could be seen as a question (or answer?) that may arise: due to the (EU) bank's need to change their business model, could social sector be of a special interest? There are at least two things to consider: financing the social sector and considering social purposes when designing products and services.

There are several reasons for traditional banks to explore this opportunity: (and the sooner they start to explore it, the earlier they could take competitive advantage):

- Social economy is increasing;
- Social economy could be seen as a sustainable sector, long-term oriented;

³ See the 22 July edition of "The Guardian". Details on Cooperative Bank's website as well (<http://www.co-operativebank.co.uk/business/community/social-enterprise-directplus>)

- As focusing on sustainability and strong principles in delivering results to communities, isn't there a low risk of adverse selection or moral hazard?
- Banks could consider and take advantage of government regulation and government support to social enterprises;
- Banks could improve their image and (re)gain popularity.

We should see new and innovative products and/or services provided by the traditional banks to social enterprises, following (and beyond) the UK bank offers.

However, social enterprises could be seen as alternatives to traditional businesses, as they create a better relation with the community and clients or even with the environment. They could be implemented by different types of organisations, targeting various social values, based on different approaches for business model. Thus, social entrepreneurs should explore the prospective solutions to finance their initiative, to evaluate which of them is the most appropriate.

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