EUROPEAN

POLICYBRIEF

MIXING AND MATCHING: THE DRIVING FORCES BEHIND FINANCING MODES OF SOCIAL ENTERPRISES

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INTRODUCTION

Enterprises with a social mission at their core emerge from the public, private or civil sector. They adopt market-oriented strategies but are often governed by principles different from those most common for commercial enterprises, non-profit or charity organisations. Social entrepreneurs combine existing logics and skills in a new and innovative way to achieve long-term social change, besides of operating in a different way.
Additionally, these kinds of organisations have, in many countries, increased since and during the last economic recession (The European Economic and Social Committee, 2012)[1], attracting the attention of policymakers, business leaders, investors and philanthropists. In particular, traditional finance market participants have also been drawn to the field, providing new opportunities to access funding, aimed to fit actions targeting certain societal or environmental problems.

Social finance is a new and multi-dimensional trend where social or environmental impact aims are incorporated in the business plans of the organisations. Among the social entrepreneurs who participated in the SEFORÏS survey, we found that 40% of social ventures from Germany, Spain, and Portugal earned more than 1 million euro in 2014. Similarly, the same figure is as large as 55.5% for the British social ventures surveyed by SEFORIS. In Portugal and Spain, the group of entrepreneurs with the lowest revenues, less than 80 thousand euros for 2014, represented about one fifth of all enterprises whereas in Germany, this group's share was slightly higher with 27%. Sweden stands out by having a more even distribution across the revenue categories. About one fifth of Swedish respondents reported to have earned more than one million euros in 2014; 14% less than 80 thousand and; and the group between 80 and 200 thousand euros representing 33.5% of the surveyed social enterprises. As in the standard business sector, revenues (which are partly financing the SEs) are often used to assess the success of an enterprise. However, foremost is still

[1] Available at http://ec.europa.eu/citizenship/pdf/eesc_qe-32-12-548-en-c_en.pdf

"creating social or environmental impact," which is the main objective of social enterprises: an effect yet difficult to fully comprehend. This motivates revenues to still be an interesting parameter to look at, as it is still often a key variable to access funding. Nevertheless, it remains unclear how much social enterprises optimally should earn or even how much revenues they should generate annually to achieve their twofold mission.

To fully understand the constraints Social Enterprises (henceforth SEs) are facing when they are growing or innovating, we keep in mind that they do so primarily for their social or environmental mission, even if generating revenues is a necessary endeavour. Indeed, funding (and financing) of SEs comes from market sources, which usually constitute traditional financing such as fees-for-services or product contracts, investments and loans. Recent funding types come with "strings attached" associated with social impact performance. Novel such tools are, for example, social impact bonds and "pay-for-success" contracts schemes. From non-market sources, social ventures could finance themselves by grants and donations, i.e. funds in cash, as well as from charity and volunteering work. Lately, micro-lending and crowdfunding platforms (e.g. Kickstarter or Kiva) have been emerging among young social enterprises, which often target specific programmes or projects an organisation run compared to everyday operation.

The optimal mix of financing sources for a social enterprise may vary along several dimensions. It depends on, among other things: business- and social sector characteristics; the organisational maturity in terms of age and development; its geographic location or scope; and the business climate and surrounding attitudes.
It is important to realize that SEs, which differ along those dimensions, could demand financing modes ever so diverse. With findings from the so far largest interdisciplinary international survey on social entrepreneurship – SEFORÏS – we illustrate different patterns and characterize the driving forces of social entrepreneur's financing.

Evidence and Analysis

This policy brief discusses the funding sources for social entrepreneurs who participated in the SEFORÏS survey. We provide an overview of the different sources of financing that contributed to the overall funding of the surveyed social ventures. Because SEs are diversified by sector, location, age, business climate, which naturally constitutes the conditions affecting organisations: we distinguish financing modes along those dimensions. The purpose is to gain better understanding of the financing modes options that are currently associated with a specific type of Social Enterprise, among the dimensions mentioned above. This underlines the social finance dynamics but also intend to illustrate some points that could benefit from improvement.

Fees and sales: the main financing source
CEOs (or top managers) of our surveyed enterprises were asked about the financing sources that their organisations used for liquidity during the past 12 months. Figure 1 summarizes their answers by showing how much (in percentage) each source contributed to the overall funding of the organisations over the year, accumulated to a country average[2].

[2] The averages are based on the number of organisations, where each SE has an equal share of the sample, hence they are not weighted by their varying sizes.

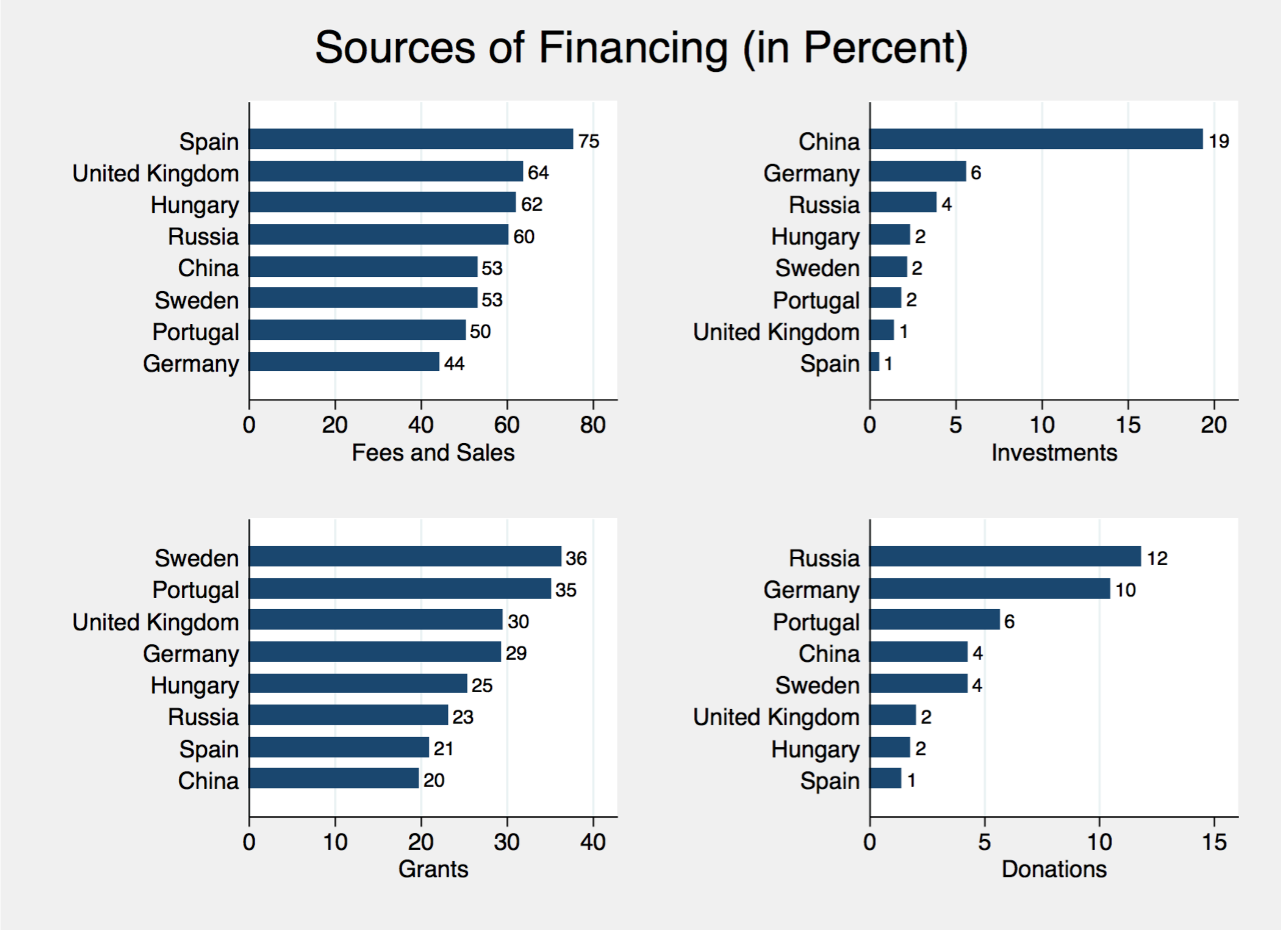

Figure 1: Sources of financing, unweighted country averages in percent of total SE financing

In general, the mix of financing varies widely within countries but also across the eight countries that we consider. On average social enterprises uses 2.54 different sources of financing.

Sales of products and fees for services are the main source of financing in all surveyed countries. This should be expected as social enterprises are, by definition, selling a service/product (with a social dimension). However, this share varies across countries. The contribution of fees and sales ranges from three quarters (75 %) in Spain, 64 % in the UK to 44 % in Germany of the entire budget. Grants are also an important source of financing. In Sweden, grants on average make up 36 % of SEs' total financing. Out of those 36 %, government grants comprise the largest part (nearly 22 %). Grants represent about 30 percent of the total revenues among surveyed social enterprises in the UK and Germany with a slightly larger share in Portugal (35 %). Apart from the direct grants that are allotted SEs by application, there are also various forms of interventions to boost the role of social ventures. Moreover, the scale and magnitude is varying across and within countries, regions and sectors alongside its success. Other sources of financing are used to a relatively small extent. Yet, one tenth of German social enterprises' budgets comes from donations. Investment is relatively important in China where available alternative sources of funding are rare, especially for the younger SEs. As a consequence, it is often the entrepreneur himself that initially finance the social venture.

This first conclusion is recapped next.
Finding 1: Fees and sales are a dominant financing source across countries.
Policy implication 1: Even though SEs generally are not entirely dependent on grants, external funding may provide more liberty of action. Many SEs may still not be self-supporting. While moving towards economic self-sustainability has positive connotations, since it is then easier to focus on the efforts that more directly benefit the social mission, it may also require bigger administrative capacities. Finding sufficient financing by using a diversified financial mix, is not only a cornerstone in how SEs work focused to achieve their mission, but also a time and skill consuming task, not least since different funding sources is associated with different logics and time-horizons.

Different financing sources do come with different logics. A larger financing share coming from self-generated means increase the freedom for the organisation to decide the growth path or how to prioritize and allocate revenues between their programs. On the other hand, self-generated revenues might be associated with a higher level of required marketing capacity and time-spent on networking and contracting. This is in addition to the time and resources devoted to measure impact (with the same standard as NGOs) and to assess their financial performance (to the same standard as corporations), could potentially impede the rapid development of the sector. We do not suggest that the requirement standards for funding are too high, but that they rather highlight why many SEs might find them overwhelming. Particularly as the required reporting standards, application forms, business language, legal competence, IT-skills and their necessary know-how are not essentially a part of what the beneficiaries gain the most from.

Public vs. Private sector in the main source of funding

Given that fees and sales are the most important source of revenue for our sample, it is interesting to carefully look at the role of the private vs. the public sector. Figure 2 illustrates this decomposition, where the overall fees and sales constitute the total. The size of the country markers represents the relative importance of this funding source, compared to other sources. The distribution between the share of fees and sales stemming from private and public sector differ across countries. For Russia, Spain, UK, China and Portugal the private sector clearly dominates. Remarkably, the fees and sales to the government are of negligible size in Russia. In Spain, the UK, China and Portugal, sales to the government amounts rather to one third of their respective share of this funding source.
Sweden and Hungary (where 53% and 62% respectively of the overall liquidity came from fees and sales) show a particularly high share of fees and sales for services supplied to the government or governmental organisations, accounting for slightly more than half of the respective shares. In the case of Germany, the balance between public and private sector is slightly tilted towards the private sector.

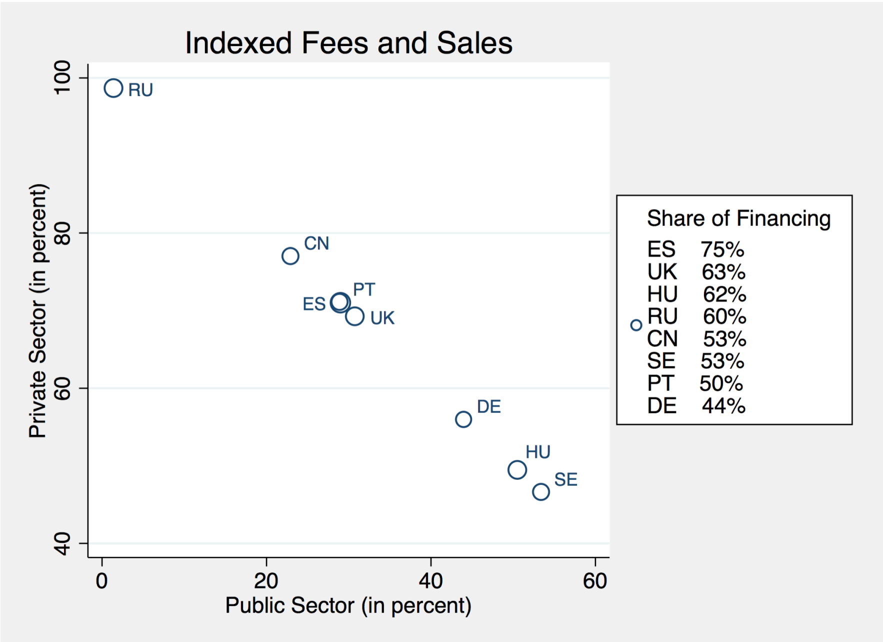

Figure 2: Public and private sector shares of total fees and sales, unweighted country averages in percent

This second point is summarized as follows.
Finding 2: The private sector represents a significant share of the fees and sales in many countries. We see that, even when fees and sales comprise a lower relative share of the total financing, as in the case of Germany and Portugal, the private sector is nevertheless the main purchaser of SEs' goods and services. However, goods and services and contract sizes are different when sold to the private sector compared to the public. This relates to existing market logics: where the government or governmental agencies either replace services and goods earlier

produced by themselves, extend welfare services provided to certain social groups or to benefit the environment; the private sector on the other hand more likely buys goods and services from SEs that compete with for-profit companies, with the exception of the private sector buying, for example, CSR services from SEs.
Policy implication 2: The private sector is essential to warrant revenues from fees and sales for SEs but this may only be achieved in a stronger competition and in smaller tranches, compared to public sector purchases. Despite potential difficulties to ensure fees and sales to the government, these might be worth overcoming due to the contracts' often desirable sizes and lengths.

Different financing sources over the life cycle
As social enterprises develop and mature, just as any other enterprise, they go through phases of market expansion or decide to refocus on their main activity. Initial actions that were taken to generate revenues (to be self-sufficient and/or for the main beneficiaries), or to generate social or environmental value and impact for the beneficiaries might be scaled up, shut down or reformed. These linear or dynamic transitions of organisations, yield different demands for financing. Figure 3 shows the most common sources of liquidity used, by age groups.[3]

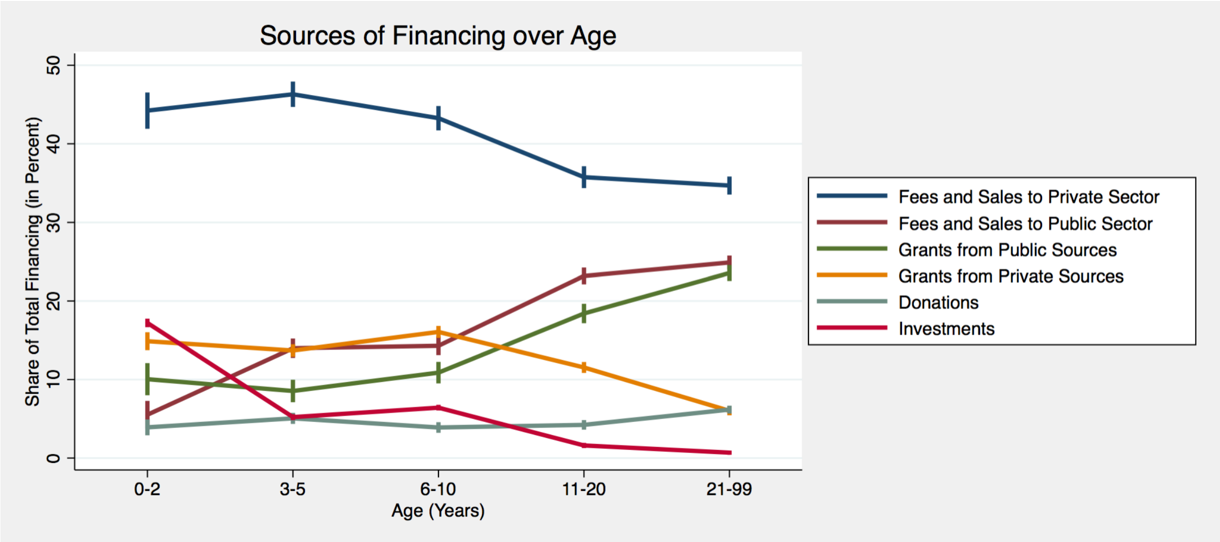

Figure 3: Sources of financing over age

First of all, it is worth mentioning that the number of financing sources also increases with organisational age, suggesting that younger businesses might be constrained in their choice of financing sources. This might also be related to the point that was stressed in finding 1, that younger SEs lack capacities to handle more than one (or sometimes two) market logics. Very mature organisations more than 20 years old use 2.89 sources of financing compared to the youngest (less than 2 years) that use only 2.10 funding types on average.
Notably, sales always constitute the most important of sources of financing, irrespective of organisational age. However, while sales to the private sector are smaller for older SEs, the share sold to the public sector is much more important for older SEs, and the same pattern is seen for grants. Finally, donations do not seem to vary particularly with the age of SEs. SEs are of course diverse and will have their own lifecycle characteristics and Figure 3 merely shows age group averages across countries and sectors.

Our third point can be summarized as follows:
Finding 3: Financing sources change over the lifecycle of the SE; early stages are dominated by private financing sources, which fade with time. As SEs become mature, there are more sources of funding available, especially from the public sector.
Policy implication 3: As seen, the private sector clearly dominates the beginning of SEs' lives, which could be explained by its ability to provide adequate/targeted funding better than the public sector. Here we highlight the potential crowding-out effect between private and public funding sources. It does not seem that, as one may have expected, that public sector does not play

3 Note that private sources include foundations, charities, venture philanthropy orgs. and for-profit companies (e.g. CSR).

a crucial role during establishment phases of the SEs, when stakes are high and activities are risky. One policy innovation could be that the public sector acts as a "quality label" for young SEs' impact and efficiency. If local or central government bodies were to take such a function we believe that it could provide SEs with a better access to other and more sources of financing. Though, currently the situation suggests the opposite, where private actors rather function as certifiers for the public sector.

Business climate and Financing sources

Social entrepreneurship and enterprising is new in its scope and in terms of its societal role when providing goods and services in the markets. In this section, we explore the link between business climates that the SEs face in the light of the financing sources they use.

As mentioned, fees and sales (in blue in Figure 4 below) are the most important financing sources for the SEs. With the exception of Hungary and Sweden, the private sector is the one creating most of the sales and fees. Parallel to this fact, we have asked the SEs in our sample to rate the support that they received from the private sector and the local government. After re-scaling (spanning from 0 to 1), letting 0.5 represents a neither good nor poor support perceived by the SEs, from the respective sectors: the all-country support average is 0.43 from the private and 0.45[4] from the public sector. By country, the red circles in Figure 4 show whether the local government or the private sector is perceived as more supportive. There is no substantial difference between them in terms of support (with country dots located between 0.4 and 0.6 of full support).

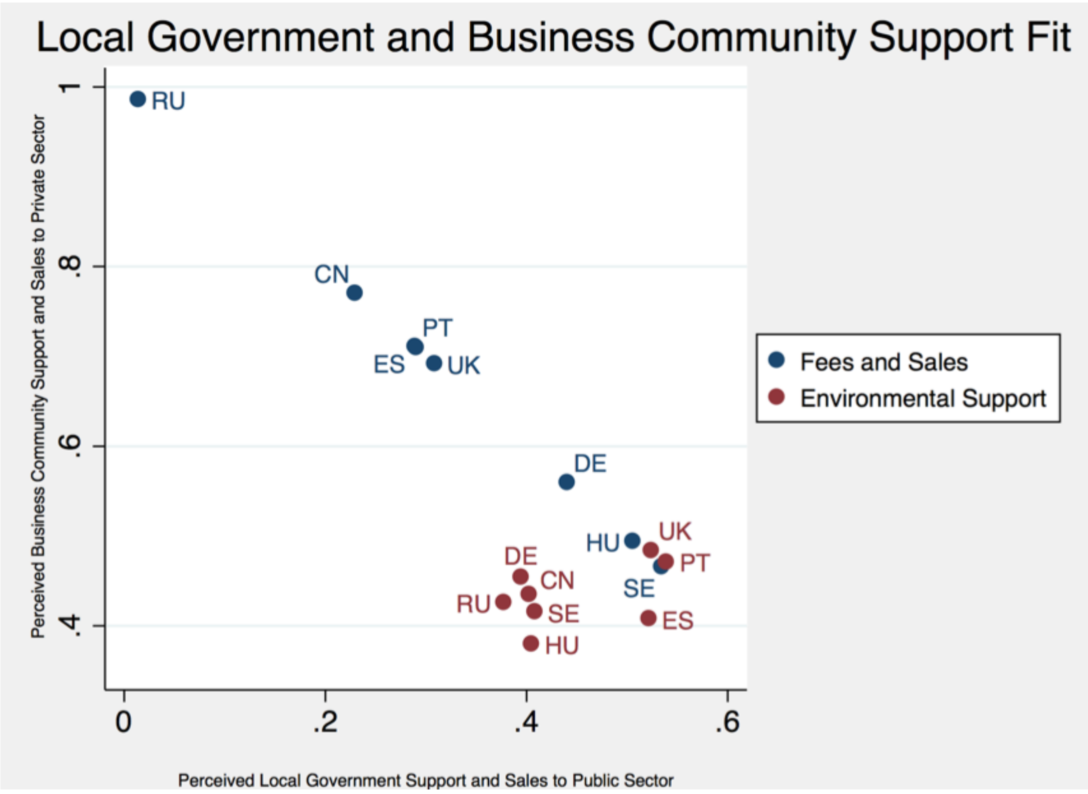

Figure 4: Support and financing sources, public/private sector comparison

Taking Sweden (SE) as a benchmark, where business climate is interpreted to be as good in the private and the local government sector. From that we can see that the remaining seven countries split 4-3, where SEs in the majority, the UK, Portugal, Spain and Hungary, view the local government bodies or agencies as providing more support than the business community. The UK, Portugal and Spain deviate from the others in perceiving more support from local government bodies than all other countries. Still that support does not translate directly into more sales to the public sector as the clear majority of sales still are to the private sector. Contrasting this with Germany, it is interesting to notice that though SEs there experience the private sector to be more

[4] For support, a value of 0 or 1 equals strong dis- or agreement respectively with a statement of experienced support.

supportive it still results in a share of sales to the public sector that bigger than for the those, where local government support is at its highest.

Russia and China, two of the countries that perceived more support from the business community are the two clear outliers in terms of the share of their total sales to the public sector. For these two countries, the local authorities have a possibility to encourage SEs by buying more from them. Overall there is likely room for a more adequate support structure that adjust for the encountered entry barriers in the two sectors. If a particular country wishes to strengthen the role of SEs, a substantial improvement of not only attitudes, but also actions, towards SEs as providers of a certain good or service might be necessary. This would mean to actively engage with and seek out SEs as potential providers of goods and services that the public needs.

Finding 4: The business climate perceived by the SEs, is overall relatively weak, with public and private support generally averaging below 0.5 on a 0 to 1 scale. To see more SEs thriving, local governments as policy makers have room to take on a leading role in supporting SEs. This is the case, even if the private sector provides the core of the financing sources.

Policy implication 4: There is a need to improve business climate for SEs. To achieve this objective, there are many tools, from improving the institutional framework (for example, introducing more transparency on funding), reducing the cost of reporting, giving social enterprises advantages such tax incentives or even requiring that traditional businesses complete impact assessments.

POLICY IMPLICATIONS AND RECOMMENDATIONS

Understanding the need for different types of well-targeted financing and how they best suit the reality of social enterprises in their endeavour to achieve a long-lasting social or environmental mission is crucial. As social enterprising emerges in the interface between traditional sectors and explore this hybridity, financing must nevertheless match this demand. It implies that common forces from multiple actors – government and other public bodies, banks, corporations, investment funds as well as individuals all over the world – join to make this kind of business surge in spite of its complexity.

As seen, financing sources bring about challenges as well opportunities. On the one hand, the increasing availability of funds designated strictly to projects with pro-social goals provides entrepreneurs with more choices of how to fund their ventures. Public and private organizations involved in social entrepreneurship have developed a number of innovative financing instruments. Two explicit examples are the “pay-for-success” contracts and social impact bonds. Likewise, is crowdfunding a rapidly growing phenomenon. Thanks to its emergence, social enterprises can harness the growing connectivity of the world by raising funds through online platforms, such as Kickstarter or Kiva. Moreover, social finance also serves as a binding element that brings different players together into collaborations. These collaborations involve different types of organizations. As our survey evidence shows, they include non-profits, for-profit firms, governments, and academic organizations.

On the other hand, formal strings-attached and difficulty of measuring social impact can be challenging for nascent social entrepreneurs working on an innovative solution to social and environmental problems. Financing is seen as an impediment by social entrepreneurs, and first of all for innovation – both in product or service. Survey respondents from all countries but China and Portugal, indicated that lack of funding as the primary innovation-stifling factor. 17% of Portuguese social entrepreneurs surveyed by SEFORIS placed financing as the major barrier to innovation after market-related barriers and regulation (44% and 20 % respectively). In Hungary, 64 % of social ventures, named financing as the primary innovation barrier, followed by UK social entrepreneurs (60%), Spain (49%), and German (44%).

It is also important to recognize that applying for funding may be expensive and time consuming. Hence, if revenues are not self-generated, many SEs may face problems to motivate and apply for funding for new IT-systems, offices, staff and other overhead costs not immediately directed to the beneficiaries. The awareness of the SE could also affect the possibility to assure funding from certain sources as well as the knowledge of the whole sector. Many countries in our study do also have national programs with funds dedicated for a certain social group or to environmental work. This means that funds are also easier to ensure for some SEs than others and it is unclear what impact these factors have on social ventures at large.

RESEARCH PARAMETERS

SEFORÏS is a flagship multi-disciplinary, multi-method international research project on social enterprise funded by the European Commission. Through the generation of robust evidence and internationally leading research, SEFORIS aims to better understand the role that social enterprises play in the EU and beyond in the development and evolutions of inclusive and innovative societies.

SEFORÏS investigated key processes through which social enterprises deliver inclusion and innovation (spanning a range of domains, from organisation and governance, over financing and innovation to behavioural change) as well as the contexts in which social enterprises thrive. In terms of methodology, we started from policy and social enterprise practitioner questions and challenges together with critically scrutinising existing academic literature. We used this first step to develop theoretical frameworks that then serve as a basis for thinking systematically about innovation and inclusion processes in context. This was followed by field and lab experimentation with social enterprises and in-depth case studies to expand and enrich our understanding of social enterprises. Unique longitudinal survey data will be collected across 9 distinct countries to test new (and at times counterintuitive) hypotheses to reach novel insights and generalizable conclusions. We engage policy makers and social enterprises throughout the research process to ensure that our research is relevant for them and can inform their practice. The project is divided into 10 work packages. WP1 to WP3 are mainly concerned with data collection. WP4 through WP8 different themes are studied and analysed. In WP9 results are disseminated and timely transfer of knowledge is ensured, while the objective of WP10 is to ensure successful delivery of the project through effective coordination.

WP1: Development of new evidence through interaction with key stakeholders
WP2: DEEP DIVE: Development of 25 in-depth cases of SEs in Europe and beyond
WP3: SELUSI 2.0 DATA on 1000 social enterprises in 9 nation states
WP4: The organization of social enterprises in market and society
WP5: The private and public finances of social enterprises
WP6: The innovations of social enterprises
WP7: Social enterprise in context
WP8: Social enterprises and their impacts
WP9: Dissemination and valorization
WP10: Governance and project management

PROJECT IDENTITY

PROJECT NAME	Social Entrepreneurship as a Force for more Inclusive and Innovative Societies (SEFORÏS)
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BUDGET

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WEBSITE

www.seforis.eu

FOR MORE INFORMATION

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FURTHER READING

List up to five current or forthcoming publications the project has produced that might be of interest to policymakers.