How to raise capital as a social entrepreneur?

How to turn your ambition to have a positive impact on the world into a business case

What 'social' investors want: 4 guiding principles

Social enterprises provide a solution for today's trends

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How do you turn the ambition to have a positive impact on the world into a business case?

Dutch social entrepreneurs struggle to find capital to start and expand their social enterprise. This article aims to address this issue by supporting social entrepreneurs who are looking for an investor. Currently, the debate concentrates on the focus of potential investors—does the investor place more emphasis on social aspects or financial ones? We identify different types of social enterprises and investors. Finding the right match requires mutual understanding.

Based on our findings we conclude that there is no trade-off. Although popular belief holds that impact and profit are mutually exclusive, the investors interviewed indicated that impact and profit are mutually beneficial. A social enterprise looking for funding needs to have a clear vision about its purpose in society as well as its financial goals. Mission drift is a potential risk in growing the business of a social enterprise. Aiming for the highest outcome, or impact, requires an alignment of financial and social goals. PwC doesn't recognize a trade-off when creating impact. It does require a thorough understanding of the business and the investor's needs. We elaborate on the results in the third chapter of the article.

We base our findings on a combination of literature analysis and ten extensive interviews with Dutch investors in social enterprises. The investors differed in size and goals and included banks, angel investors, investment funds and more. When analyzing the results we were able to identify overarching themes that applied to the majority of the investors in their investment cases.

1. Access to capital is crucial for the growth of the Dutch social enterprise sector

1.1. Dutch social enterprises experience difficulty accessing capital

In the UK and in the US the social enterprise sector emerged earlier, and is more developed, than in the Netherlands[1]. These and other governments support the sector in various ways. One of the instruments used by governments in order to facilitate or even boost the sector is specific tax and legal regulations or, more far-reaching, specific incentives such as tax breaks. This is not (yet) the case in the Netherlands. Still, with or without government intervention, Dutch social entrepreneurs are keen to play their part in developing the Dutch social enterprise sector. In doing so, they experience challenges, one of which is accessing the necessary capital to start or grow their organization[2]. Social enterprises struggle to find investors[3] and convert their belief into an investor-ready business case. The lack of easy access to capital results in stagnating expansion for individual social enterprises and the social enterprise sector in general.

Although accessing capital is a challenge faced by many 'regular' businesses as well, there is an extra dimension for social enterprises as potential investors need to be willing to take the enterprise's financial and social mission into account. Social enterprises also often propose innovative ways to solve a problem, thereby making it hard to point to earlier success stories of other organizations. In this article we try to close the gap between social enterprises and investors. We identify causes for the current mismatch in understanding and providing practical recommendations.

1.2. Finding a good match between social enterprise and investor is key

Investors differ in their approaches to topics such as social return, financial return and risk. Likewise, social entrepreneurs differ in how they balance and align social and financial factors. Having a good understanding of what one's organization has to offer may sound as an obvious requirement, but gaining this understanding is crucial before the social enterprise approaches potential investors. This is key in finding the right investor for the purpose of the enterprise. Too often investors are confronted with a 'scatter-shot' of ideas.

1 McKinsey & Company (2011) Opportunities for the Dutch Social Enterprise Sector. Amsterdam, p. 4.
2 McKinsey & Company (2011) Opportunities for the Dutch Social Enterprise Sector. Amsterdam, p. 11.
3 Kennisland, Social Enterprise NL (2013) Stimulansen voor de social enterprise sector: Ervaringen en lessen uit Europa, p. 7.


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2. Balancing primary objectives results in different types of social enterprises and investors

2.1. We focus on starting social enterprises

There are multiple social enterprises, each one of them with another focus. There are organizations that start as a social enterprise with a clear purpose, while others move from existing organizational models towards becoming a social enterprise. There are three possible starting points (see figure 1).

Firstly, charities such as NGOs may move from "pure" philanthropy (donations) towards an entrepreneurial approach, for example by providing paid services or offering loans instead of grants. Secondly, traditional "for profit" companies are increasingly becoming more social by redefining their mission and incorporating social goals alongside financial ones. Finally, there are social enterprises which combine social impact and profit from the start. This is a relatively new category and these organizations are generally younger, without existing investment relationships.

Even so, they need capital in order to start-up, flourish and grow. Although NGOs and traditional companies also need investors, we focus on start-ups with limited resources at their disposal, because they face the greatest challenges attracting an investor. Improving their access to capital is likely to give the greatest boost to the emerging social enterprises sector.

Investors note that social entrepreneurs often lean towards either entrepreneurship (i.e. the business side) or idealism (i.e. the social mission) as shown in figure 1 above. The entrepreneurs that focus on entrepreneurship merely have a more solid business plan, but they might struggle to integrate the social mission into their enterprise. In extreme cases this shows entrepreneurs trying to be a social enterprise, because the term is starting to get more and more attention. Idealists on the other hand focus more on the social mission and the contribution they want to make to society, making this a core part of their business model. Their weak spot often lies in the difficulty to formulate a solid business case and the lack of a clear idea about how to become financially stable. As one investor noted: *"Some entrepreneurs would be more successful in an NGO and shouldn't bother trying to be an entrepreneur."*

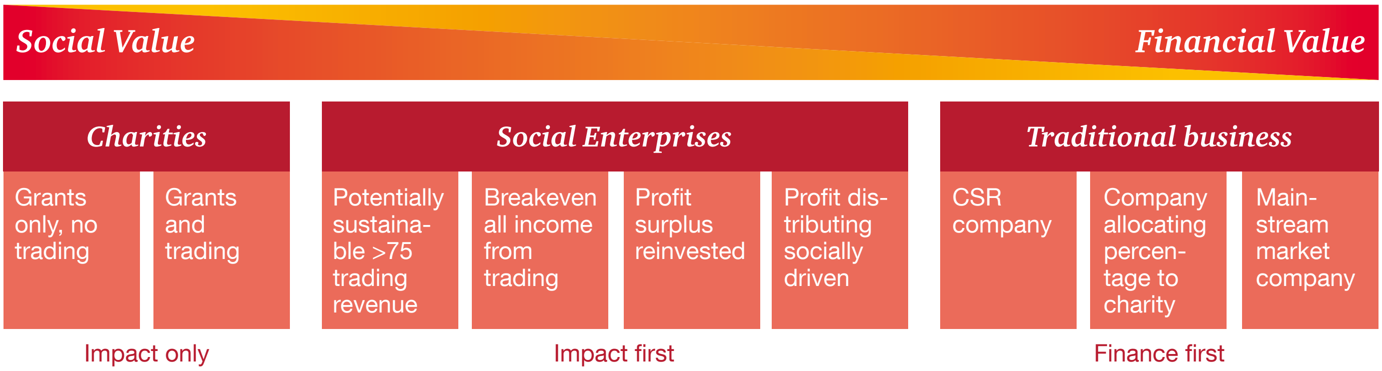
A social enterprise combines both impact and profit

There is discussion about the exact definition of a social enterprise, but the European Union uses a widely accepted definition.

This definition states that a social enterprise is a company:

- with the primary objective to achieve social impact rather than generating profit for owners and shareholders;
- which uses its surpluses mainly to achieve these social goals;
- which is managed by social entrepreneurs in an accountable, transparent and innovative way, in particular by involving customers and stakeholders affected by its business activity.

Figure 1. An overview provided by Shaerpa



2.2. We have identified five types of investors

We have identified five types of investors interested in investing in social enterprises. Below we briefly outline the main characteristics of each type.

1. **Angel investor:** these investors invest in an organization based on ideological considerations. This means that the social mission of the investment target is the primary objective. Angel investors focus strongly on social return before financial return. They often provide financial aid to start-ups and the amount of capital invested is relatively small, which means the risk for the angel investor is low. The capital can be a one-time financial injection or ongoing support to carry the company through difficult times (e.g. the start-up period). Angel investors may be among the social entrepreneur's family and friends, but can also be established foundations.

2. **Crowd funding:** crowd funders make use of platforms that bring together small amounts of capital from a large group of individuals. These individuals work together because they believe in the social mission and/or business model of a social enterprise. Depending on the group of people that participate, the focus can be on the social mission or the financial possibilities (in fact, this may differ per individual crowdfunder). To attract investors, crowdfunding makes use of the easy accessibility of vast networks of friends, family and colleagues through social media websites. As with angel investors, the amount invested per person is generally small, although the overall investment may be large.

3. **Financial institution:** these organizations have a significant sum of capital available and place more emphasis on financial return. The social mission is not necessarily the main business objective as is often the case with crowdfunders and angel investors. While financial institutions invest relatively large sums of money in social enterprises, they tend to choose less risky investments than venture capitalists.

4. **Investment fund:** this investor has a large, often conservative, amount of capital available. Investment funds aim to ensure steady growth in capital over the long term. Think for example of a pension fund—although stakeholders appreciate socially responsible investments, they are also interested in the long term financial returns. Due to its future payment obligation, investment funds, such as pension funds, focus more on financial return than on social return and look for low risk investments.

5. **Venture capitalist:** this investor invests a large sum of money in start-up firms and small businesses with expected long-term growth potential. The risk for investors is high, but investments have potentially high returns (both social as well as financial).

How to raise capital as a social entrepreneur?

3. What 'social' investors want: 4 guiding principles

The 'million-dollar question' is how the above observations can help social entrepreneurs to improve their access to funding. Based on our discussions and observations we formulated 4 guiding principles for social entrepreneurs when trying to get access to capital. Having an in-depth understanding of the business increases your chances of finding the right investor for the purpose of the enterprise. Focus and a clear vision of the purpose of the social enterprise can result in optimal impact for both parties.

3.1 Trade-offs do not exist! Alignment between financial and social objectives is key

According to popular belief it is impossible to 'do good' and make a profit at the same time. However, the investors we interviewed tell a different story: profit (or a solid financial base) and impact can and should both play a prominent role. As a representative of a financial institution puts it: 'We expect that the social enterprise shows a convincing (social) mission, but also a convincing business case.' When integrated, the two aspects strengthen each other, making an attractive financial return to expand your impact. There are already many well-known examples. Taxi-Electric, a price competitive taxi service that runs its cars on electricity and employs the long term jobless is increasing its impact by selling as many taxi rides as possible. Tony Chocolonely and Specialisterren are also well-known examples of social entrepreneurs, who increase their positive impact as they grow their sales and revenue. Increasing the effect of your social mission can increase financial gain and vice versa.

Investors look for organizations in which both aspects come together in an integrated way. This said, the starting point might differ for investors as shown chapter 2. For instance, angel investors might invest in idealists and look for ways to improve the entrepreneurial side of the social enterprise, while investment funds often start working with social entrepreneurs by focusing more on the entrepreneurial/ financial side and assisting them with integrating their social goals.

A social enterprise integrates both the social mission and the financial drive to maximise its impact. Any suggestion that there might be a trade-off between the social and financial goals will weaken the business case. Investors not only expect you to have a clear understanding of your social goals and your business model, but they must be able to observe the integrated approach and vision. Most business cases that investors receive don't have a firm basis for making investment decisions. Be prepared to discuss and optimize your plan together with your investor.

3.2 Build and present a well-balanced management team. An investor will never believe that you make it on your own

Investors stress the importance of a team that shows its commitment to the social enterprise, rather than a single person. Having a group of people willing to invest time and effort in the social enterprise is regarded as an indicator of future success. Investors look for a social enterprise with a strong (management) team that shows a balance of complementary skills. Financial institutions, investment funds and venture capital firms specifically mention that they look for these signs when considering an investment. Yet, this does not mean it is impossible to get funding on your own. Crowdfunding and angel investors, for instance, do support individuals, but in general investors are more likely to invest in a team. So, it is advisable to consider the inclusion of more people at an early stage. Gathering a management team in the organization that consists of a diverse group of people

‘The question remains how to get started. To prevent early dissolution, start with something small, easy to measure, preferably already available in your daily business.’

is preferred by investors. Apart from finding a suitable investor, it may strengthen your own organization as well. As one investor puts it: *"Having more than one person gathered behind a leader or an idea shows persuasiveness and is a good indication that customers might follow."*

3.3 Measure your impact! Your contribution becomes visible if measured

Social enterprises find it difficult to measure their impact or at least quantify their outcome. Investors remarked that social enterprises often express that a lack of resources is one of the reasons for this. While not all investors set impact measurement as a minimum requirement before investing, all the investors that were interviewed indicated that it does make a stronger case.

Financial institutions and venture capital firms expect the social enterprise they invest in to measure and quantify their impact. Other investors also look for ways to measure impact, but place less emphasis on it. All investors recognize the difficulty in measuring impact from their mission statement and at the same time acknowledge the value. *"We see that it helps social entrepreneurs to bring focus to their work and identify more clearly what their goals are."*

The way social enterprises measure impact depends, among other things, on the maturity of the organization. Starting organizations may for example find enough comfort in qualitative indicators, while the more experienced entrepreneur will often look for quantitative impact measurement. There is no consistency between investors with regard to what they ask and how they want to measure impact, but every investor is looking for ways to improve the effectiveness of the social enterprise by assessing the impact.

The question remains how to get started. To prevent early dissolution, start with something small, easy to measure, preferably already available in your daily business. An example would be to measure the number of people you employ or the amount of positive feedback you receive. Every method has its limitations and there is no perfect system, but it allows you to see the progress you make and it brings focus to your work. Taking the question 'why' you want to measure your impact as a starting point will contribute to your alignment of financial and social objectives.

3.4 Avoid mission drift at all times!

Mission drift occurs when an enterprise moves away from its initial mission. This usually takes place after a couple of years, for example with new employees, leaders, owners or when a new investor is interested. Investors see mission drift as an issue when the focus of the social enterprise shifts from a balanced view towards financial gain, at the expense of the social mission. If mission drift occurs to the extent that the pursuit of financial gain no longer contributes to the pursuit of social gain, the mission may no longer be in line with what was initially discussed with the investor. Investors are therefore hesitant to commit themselves to long term investments. In theory, mission drift can also take place from a strong financial focus towards a more idealistic one. However, this rarely occurs with regard to young social enterprises.

Moving away from the initial mission is not necessarily a negative development. It depends on the expectations you and your investor(s) have. If you move more to financial gain, for instance, it is important that you are on the same page as your investors. Communicating expectations is the key message.

Investors indicate that they find it increasingly important to discuss mission drift at the start of the investment. This is because they see mission drift occur around them. Aligning expectations and creating safeguards on this topic is important to prevent confusion and tension in the future.

Furthermore, starting the discussion with your investor on this topic shows that you have thought about how you can run your business in a sustainable manner. If you come to the conclusion that you want to prevent mission drift there are different steps you can take. For example, you can include mitigating activities in the business plan, include legal entities or set up a supervisory board.

4. Making an impact as an investor and social entrepreneur

"The Dutch social enterprise sector is lagging behind frontrunners like the US and UK" as stated by Willemijn Verloop (founder of Social Enterprise NL). One of the reasons for this is that social enterprises struggle to find investors. Based on our research we suggest four guiding principles for social enterprises in order to improve their access to capital. Knowing where your social enterprise stands occupies centre stage. You should ask yourself what type of investor best matches that profile.

Knowing where you fit in the spectrum (i.e. refer to figure 1) can be a good indicator for blind spots you naturally have. Improvements can be made by aligning your business case with both social and entrepreneurial goals of a social enterprise. Building a well-balanced team supports that business case and measuring the impact shows its viability. Avoiding mission drift ensures that you stay on the right path. Doing this together with your investor creates the most significant output, outcome or even impact in the long run.

5. PwC believes that social enterprises provide a solution for today's trends

The European Union has explicitly mentioned the sector as a solution towards solving social problems in a more effective and economic profitable manner. Entrepreneurs in many countries are working tirelessly to prove the EU right. PwC actively supports this growing sector in the Netherlands.

Social enterprises received significant attention in recent months. Although this is nothing new, it does show the need for a more balanced stakeholder approach in doing business. The social enterprise sector is sometimes even called the fourth sector. We believe that all three traditional sectors should embrace this young emerging sector. The public sector can support social enterprises by creating rules and regulation or cutting red tape.

The private sector can support social enterprises with advice on various areas of doing business (e.g. impact measurement, legal advice, financial advice, strategic advice). NGOs can support social enterprises by providing advice on how to bring across the social mission. Each sector, in turn, can learn a great deal form this emerging sector in the process. It shows how a well-balanced stakeholder approach is the way of doing business in current markets.

The most important factor is that we recognize the potential (disruptive) power, as well as the positive impact this sector can have on society as a whole. Supporting the movement starts with a continuing dialogue and a discussion of the required next steps. We invite organizations both within this sector and beyond, to work together and explore the opportunities.

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