

Current Issues in Social Entrepreneurship: Funding and Finance

By Cleveland T. Justis

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The sheer quantity of capital moving to help solve social problems is staggering. In 2009, the worldwide capital flowing from wealthy countries to developing countries topped \$476 billion. Of these funds approximately 75% came from philanthropy, remittances, and private capital investment, while governments contributed the rest.¹ The United States is clearly the largest player, with its foundations donating \$4.3 billion annually, its corporations \$7.7 billion, its nonprofits nearly \$14 billion, and its religious institutions over \$8 billion.²

A much broader opportunity exists if one also considers the market for “socially responsible” products, social change work, and socially responsible investing. The relatively new term social capital has emerged to describe this market. Even with increased attention focused on this sector, determining the actual size of the social capital market is challenging. Renowned former Goldman Sachs executive David Blood, notes that asset owners and managers representing over \$8 trillion are recognizing that environmental, social, and governance factors drive value creation.³ Hope Consulting estimated the opportunity at a more modest \$120 billion.⁴ Regardless of the exact size, we know it is massive.

Historically, funds from individual donors, personal relationships, and large foundations provided the means to fund social ventures. Now, a much more nimble system is evolving—a system based on impact, technology, transparency, and metrics. The age-old challenges and limitations posed by traditional capital flows and markets still exist. Yet microfinance models, Internet-based funding, and innovative partnership approaches are providing new solutions to these problems. While these are not a panacea for solving the challenges of funding, they are giving a tremendous boost to the capital available to this market and, more importantly, providing much-needed innovation in the field. When taken in their entirety, the funding and financing opportunities are larger than ever before. Capital is moving in new ways and organizations are responding with remarkable innovation. The purpose of this article is to highlight some of the innovations and trends in the field of social entrepreneurship.

Recent Innovations in Social Entrepreneurship

Microfinance

The Bangladeshi economist and founder of the Grameen Bank, Muhammad Yunus, is largely credited with catalyzing a worldwide marketplace of microcredit. Starting in 1976 by making tiny (usually less than \$10) uncollateralized loans, the bank now serves nearly every village in Bangladesh, lending over \$100 million/month in collateral-free loans averaging less than \$200/each.⁵ Today the worldwide size of the microcredit marketplace is estimated to be over \$33 billion and growing at 25% annually, with over 1,200 microfinance institutions with 53 million borrowers.⁶

Over the past 10 years, a number of successful nonprofits have harnessed the power of technology to advance microcredit. Among the most prominent is Kiva, which as of 2011 loaned almost \$200 million in increments of approximately \$25.⁷ The real innovation of Kiva is that the donor can connect directly with the project. All of the lending takes place online with the lender choosing a project of interest from those highlighted on Kiva's website.

Increasingly, large lending and aid institutions are using microcredit instead of large-scale capital approaches as a way of helping entrepreneurs. Recently, the World Bank committed over \$4.5 billion to small and medium enterprises in over 50 countries.⁸ World Bank funding of microloans is greatly augmented by the other various multilateral financing institutions. Even the U.S. government established a \$75 million domestic microloan program to distribute in increments as small as \$200. The loans charge an interest rate of approximately 10%, a huge opportunity for many social entrepreneurs who would typically have to pay interest as high as 29% if borrowing from a credit card (the likely source of loans because banks will not normally lend to social entrepreneurs).⁹ With major banks getting into the business, we are seeing an important migration from smaller microfinance



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institutions to larger banks and traditional financial institutions that see microfinance's tremendous opportunity. Clearly small loans are now a booming business.

Impact Investing

Impact investing is a term coined by a group of investors convened by the Rockefeller Foundation in 2007 to refer to a broad array of profit-seeking investment strategies that generate social and environmental good as well as a strong financial return (social capitalism and philanthrocapitalism are terms also used to describe nearly the same activities). The Monitor Institute estimates that the total size of the global impact investing market could be as big as \$500 billion within the next decade.¹⁰ According to Monitor, impact investors actively seek to place capital in businesses and funds that can provide solutions at a scale that philanthropy or government usually cannot reach.

Given the sheer size of the opportunity, much attention is being paid to impact investing approaches. Many large banks, financial institutions, and foundations are interested in the success of this emerging approach. Massive amounts of previously unavailable capital are accessible to entrepreneurs who are blending for-profit financial models with positive social impact goals.

Venture Philanthropy

Arising in the late 1990s, venture philanthropy refers to a broad approach where philanthropy takes on a venture capital model. Philanthropy is viewed more as an investment than a traditional donation, and in some cases the philanthropist is expecting to be repaid the investment. The social sector entrepreneur often forms a more hands-on relationship with the philanthropist. This can be particularly helpful if the social venture's team needs a particular skill set that is lacking on its present board or staff.

The arrival of this new approach generated considerable attention. While many thought venture philanthropy would re-invent the field of philanthropy, this has not materialized. Estimates of the scale of venture philanthropic giving vary, but the amount is small relative to total giving. For example, in 2001, arguably the heyday of venture philanthropy,

it accounted for less than 0.2% of total foundation giving.¹¹ Regardless, social sector entrepreneurs are advised to understand venture philanthropy as many potential donors appreciate its approach to impact, even if it is not the exact model which their giving follows. Further, for the right entrepreneur, an investment from a venture philanthropist can make a huge difference. For example, the founders of many successful nonprofits such as Kiva and Room to Read credit their success to the early mentorship and financial support they received from venture philanthropy.



Hybrid Models

Hybrid models attempt to synthesize for-profit and nonprofit structures that allow the best of both models to emerge. Typically, the hybrid model allows the entrepreneur to own the for-profit enterprise yet generate the primary social impact through an affiliated nonprofit and/or foundation. Sometimes the activities of a for-profit business are quite different from those of generating social impact. Hybrid models attempt to resolve this challenge.

For the entrepreneur, hybrid models also can be effective in keeping ownership control and allowing the enterprise to flourish as a for-profit. At the same time, the nonprofit can receive philanthropic funds and many of the tax advantages and public-perception benefits afforded to nonprofits. One of the better-known hybrid models is World of Good, Inc. World of Good was incorporated to sell small artisan-made products from around the world through distribution channels with major retailers like Whole Foods. World of Good Development, its nonprofit partner, was charged with developing a free online tool to help calculate a fair wage and improve negotiating power with buyers.¹² The for-profit was

venture capital funded with investors expecting a market-level return; the nonprofit owned 5% of the for-profit and held claims on 5% of the profits of World of Good.

Hybrid models can come with some significant downsides. First, they can be expensive and complex to establish. Often the organization needs to invest in proper legal advice to ensure that all details are handled properly. Second, many traditional donors do not understand hybrid models and the entrepreneur may need to invest significant time and energy in explaining the structure. Finally, sometimes the cultures of the for-profit and nonprofit can be quite different and this can be difficult to manage. In the case of World of Good, all three of these factors may have been at play when it decided to dissolve the hybrid in 2010. World of Good's commercial unit was bought by eBay, and the nonprofit now operates independently.



Major Current Trends Affecting Social Entrepreneurship

Social Media and the Role of Technology

One cannot overestimate the impact of social media and technology on funding social ventures. The rise of connectivity across the globe is fueling unparalleled access to entrepreneurial capital. With nearly one billion users across the globe, Facebook has been credited with helping activists topple oppressive governments, catalyzing donors, and building social connectivity among those never previously connected. Combined with nearly omnipresent cell phone technology worldwide, social media will forever change the relationship of social entrepreneurs to their work.

One of the first examples of this is President Obama's 2008 election campaign that launched an unprecedented social media strategy connecting social media with a robust network of micro-donations. In less than 18 months, Obama raised a record-setting \$600 million. Most remarkable to many is that Obama's campaign raised the money, often in \$25 increments, from millions of donors. The Obama team deftly used social technology to parlay millions of tweets on Twitter, Facebook posts, and YouTube videos into a clear social mandate and financial machine. The Obama campaign highlights that the potential for technology and social media to play a critical role in financing social ventures is enormous.

Fundamentally, social media allows entrepreneurs to deeply connect with supporters in ways never before possible. A good example of success is the small nonprofit Mobile Loaves and Fishes, which developed a campaign that would not only launch its new text-to-give option, but also raise awareness about the issue of homelessness and the mission of the organization. Using an integrated social media strategy, Mobile Loaves and Fishes garnered 230 news stories in 31 media markets, received 1.3 million social media impressions, and raised more than \$12,000 in 48 hours.

Rise of Decentralized Micro-Giving Opportunities

As a result of advances in technology, a wave of new giving opportunities has emerged, thus changing and decentralizing the capital market for social ventures.

As mentioned earlier, Kiva sparked a revolution in decentralized microlending that has now reached over \$9.5 billion in loans spread among 13 million

borrowers, according to World Bank estimates. Kiva's website features a directory of 400,000 entrepreneurs around the world seeking microloans. Loan amounts typically fall well under \$35,000, and as little as hundreds of dollars in some developing nations.¹³ This is likely only the beginning. Social science trends show that donors increasingly want a connection to the work. Donors now have a dizzying array of decentralized giving opportunities ranging from cell phone giving to texting to websites like Kiva's.

A related trend is "crowdfunding," in which individual entrepreneurs post a project or company idea on one of several sites in the hope of finding investors. Entrepreneurs typically include details on monetary goals, an explanation of how the funds will be used, and an end-date for the campaign. Crowdfunding works more like a traditional equity investment; investors are expecting to be paid a cut of future profits, rather than to be paid back with interest, as with microlending. The crowdfunding concept originated in 2008 as a way for photographers, filmmakers, musicians, and other artists to cobble together funding—usually from their fan base—in order to complete their creative works.

The number of charities and entrepreneurs finding great success with receiving donations online is also growing rapidly. Recent industry surveys show that electronic fundraising is growing at a rate of 35-40% annually.¹⁴ This means that entrepreneurs

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have an ever-increasing ability to connect directly with donors and show them the impact of their funding investments. For example, the Red Cross partnered with the National Football League to raise funds in response to the 2010 earthquake in Haiti. Text-message donations coming in at a rate of \$500,000/hour totaled about \$22 million.¹⁵

Transparency

With these changes in technology, organizations now face new requirements for transparency in the work they do. Although the full implications of this are unknown, it is clear that donors will have new visibility into the work of organizations. One might expect that this will favor organizations making the greatest impact.

However, with new access to information can come a host of unexpected challenges; for example, given the new availability of information, more and more charity rating services are coming into existence. Organizations like Charity Navigator, Guidestar, and the American Institute of Philanthropy provide unprecedented access to information about a nonprofit organization's activity. While this may lead to better accountability of organizations' work, it may also further exacerbate a well-documented incentive system where social-sector leaders distort their reporting activities and report more work as programmatic and less work as administrative.¹⁶ While perfectly legal, the practice of managing to the metric of charity rating services may obfuscate rather than highlight the efficacy or impact of an organization.

Cross-Sector Partnerships

While not necessarily new, cross-sector partnerships are blossoming. Corporations, nonprofits, and governmental entities are collaborating to a degree never seen before. In fact, this has become the new norm of business. Ninety percent of more than 600 business leaders surveyed by the Pew Partnership for Civic Change reported that partnerships with civic, community, and nonprofit organizations were becoming increasingly important instruments for

solving social problems.¹⁷

This blossoming of partnership presents some incredible opportunities for social sector entrepreneurs and for the funding of social ventures. Corporations have resources beyond the imagination of many nonprofits. Nonprofits have brand credibility and flexibility that are the envy of many corporations, including their high level of regard in the eyes of the public. Governments typically have neither vast financial resources nor flexibility, but they do have immense regulatory power that can be harnessed by nonprofits and corporations to contribute to society's betterment.

While partnerships usually sound appealing, most leaders and organizations that engage in cross-sector partnerships note their difficulty. Particularly noteworthy is a recent article that observes that for the 9 of 10 mergers or joint ventures within the business sector that fail, the cause is that their organizational cultures clash.¹⁸

In his compilation paper on partnerships,¹⁹ Ben Jupp noted four key elements present in successful partnerships.

- Clear objectives are present.
- All parties benefit from the partnership.
- Evaluation and success metrics are present.
- Partners understand one another's organizational cultures and trust is built.

Management literature is filled with detailed accounts of what makes partnerships work. Leaders engaged in cross-sector partnerships are well advised to study best practices and case studies in advance of partnership work.



Alternative Corporate Structures

Entrepreneurs choosing a nonprofit structure are afforded a number of legal and tax-related benefits, but also face a dilemma because they do not own the enterprise and may lose ownership control because the board of directors is the legal entity responsible for the organization. In general, a nonprofit organization is one that is organized to achieve a purpose other than generating profit. Despite this, a nonprofit organization is not precluded from making a profit or engaging in profit-making activities. It is prohibited from passing along any profits to those individuals who control it such as founders, directors, officers, employees, and members. Nothing, however, prevents a nonprofit from paying reasonable salaries to officers and employees, or from retaining profits generated. For entrepreneurs who have undertaken significant financial risks and sacrifices, this structure may be undesirable because they may want to retain control and profits for all of their work.

To remedy this situation, a number of innovative corporate and legal structures are emerging. One such corporate structure is the Benefit Corporation (B-Corp), which is taking hold in a number of states including California, New Jersey, Maryland, and Vermont. The B-Corp structure makes it possible for companies to legally consider the interests of other stakeholders when making decisions and protects the company's owners from shareholder lawsuits for making decisions based on stakeholder interests, rather than simply on profit maximization.

Another emerging corporate structure is the low-profit, limited-liability company, or L3C, a new structure applying to for-profit ventures that have a primary goal of achieving a socially beneficial purpose. While many L3Cs have purposes similar to nonprofits, they can distribute their profits to shareholders. By law, L3Cs are called "low-profit" companies, because

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profit is a secondary goal. L3Cs pay taxes on income as all limited liability companies do, and contributions to L3Cs are not tax-deductible as they would be for a charity. L3Cs also have a major advantage over limited liability companies in that they can easily receive foundation funds. L3Cs can be formed in Michigan, Vermont, Illinois, Wyoming, Utah, North Carolina, Maine, and Louisiana. Once formed in any of these states, the L3C can operate legally in all 50 states.

Increased Oversight from Regulators

Major corporate and accounting scandals at large companies shook the public's confidence in the quality of information provided by major corporations. A significant piece of legislation, the Sarbanes-Oxley Act adopted in 2002, established major new rules relating to disclosure, governance, auditing, and other key information. While applying only to publicly traded corporations, the Sarbanes-Oxley Act fueled a growing interest in similar disclosure requirements for nonprofit organizations. A wave of regulations followed for the nonprofit and social sector, culminating in the California Nonprofit Integrity Act, the revision of the forms filed by nonprofits with the Internal Revenue Service, and calls for increased IRS oversight of nonprofits.

This may lead to further professionalization but it is also an additional level of detail and complexity that the social sector entrepreneur will need to manage. While the exact future of governmental oversight

of nonprofits is not yet clear, it is obvious that more oversight and scrutiny are on the way. The social entrepreneur is well advised to stay abreast of the trends in this area.

Resurgence of the Mega-Foundation

Much of the history of philanthropy is dominated by mega-foundations such as Kresge, Ford, and Rockefeller. Over the past 200 years, these foundations have poured billions into improving society, building libraries, enhancing universities, forging advances in health care, and many other worthwhile causes. Today, the combined assets of the world's 25 largest foundations total about \$220 billion. In the United States alone, foundations overall control about \$500 billion of assets in nearly 18,000 active foundations. While this paper has emphasized the power of emerging capital sources, it is worth noting that large foundations will continue to be a critical and enduring source of financing for social sector entrepreneurs. In fact, 40% of the larger foundations were formed in the last 10 years. With the recent commitment of some of the world's wealthiest people to give half of their fortunes to charity, the amount of money pouring into foundations will likely accelerate.

Conclusion

As this paper highlights, financing structures and opportunities are evolving quickly, and entrepreneurs face increasing opportunities to find a structure that meets their needs. While these changes and opportunities can be daunting to entrepreneurs, hard-working and ethical leaders can make an enormous impact on people's lives.

It is an exciting time to be in the field of social entrepreneurship. Never before have we had such a powerful coalescence of forces where impact, profitability, funding sources, and public interest align so seamlessly. The field has billions of dollars flowing into it—clearly investors have a growing need for impact and are impatient with rigid institutional giving structures. For today's entrepreneur, it may be the case that leadership and strategy are the primary limitations rather than funding sources. Funding appears to be becoming infinitely more flexible and responsive to the needs of the entrepreneur. For the social entrepreneur, this presents a remarkable opportunity to change the world in ways never before possible.

¹ Center for Global Prosperity, Index of Global Philanthropy and Remittances 2010 (Hudson Institute, 2010), 14.

² *Ibid.*, 18-35.

³ Lenny T. Mendoca and Jeremy Oppenheim, "Investing in sustainability: An Interview with Al Gore and David Blood," *www.mckinsey.com, McKinsey Quarterly*, May 2007.

⁴ "Money for Good: The US Market for Impact Investments From Individual Donors and Investors," May 2010, www.hopeconsulting.us.

⁵ Muhammad Yunus, *Building Social Business: The New Kind of Capitalism That Serves Humanity's Most Pressing Needs* (PublicAffairs, 2010).

⁶ "Microfinance Banana Skins 2008. Rich in a booming Industry" (Centre for the Study of Financial Innovation).

⁷ "Kiva—Facts & History," <http://www.kiva.org/help/facts>, accessed 3/6/11.

⁸ "News & Broadcast - Microfinance - WorldBank", <http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:20433592~menuPK:34480~pagePK:64257043~piPK:437376~theSitePK:4607,00.html>, accessed 3/6/11.

⁹ "LENDING; Sharon Bernstein, 2010. LENDING; When small firms need a little boost; A federal microloan program has \$75 million to distribute, bit by bit. Los Angeles Times, October 16, <http://www.proquest.com>, accessed 4/3/11.

¹⁰ "Investing for Social and Environmental Impact: A Design for Catalyzing an Emerging Industry" (Monitor Institute, 2009).

¹¹ *Ibid.*, 326.

¹² Stephanie Strom, "Hybrid Model for Nonprofits Hits Snags," *The New York Times*, October 25, 2010, sec. Business Day,

http://www.nytimes.com/2010/10/26/business/26hybrid.html?_r=1&pagewanted=print, accessed March 23, 2011.

¹³ "Kiva Expands Microlending Reach to U.S. Businesses. (2010, October 22). *Wall Street Journal* (Online), accessed March 15, 2011, from *Wall Street Journal*. (Document ID: 2170069661)."

¹⁴ "Online Giving a Bright Spot in 2010 - Prospecting - The Chronicle of Philanthropy- Connecting the nonprofit world with news, jobs, and ideas," <http://philanthropy.com/blogs/prospecting/online-giving-a-bright-spot-in-2010/29009>, accessed 3/21/2011.

¹⁵ Stephanie Strom, "A Deluge of Donations via Text Messages," *The New York Times*, January 18, 2010, sec. U.S., <http://www.nytimes.com/2010/01/19/us/19charity.html>, accessed 3/21/2011.

¹⁶ Krishnan, Ranjani, Yetman, Michelle and Yetman, Robert J., *Financial Disclosure Management by Nonprofit Organizations* (July 19, 2002). Available at SSRN: <http://ssrn.com/abstract=319581> or doi:10.2139/ssrn.319581.

¹⁷ "Pew Partnership for Civic Change. 2001. In it for the long haul: Community partnerships making a difference. Philadelphia, PA: Pew Partnership for Civic Change," accessed 3/13/11.

¹⁸ Ben Jupp, *Working together: creating a better environment for cross-sector partnerships* (Demos, 2000).

¹⁹ *Ibid.*

²⁰ "New corporate structure could give social entrepreneurs new funding stream," *Chicago Tribune*, n.d., http://articles.chicagotribune.com/2009-08-10/news/0908100018_1_program-related-investments-profit-social-mission, accessed 3/13/11.

²¹ "List of wealthiest charitable foundations - Wikipedia, the free encyclopedia," http://en.wikipedia.org/wiki/List_of_wealthiest_foundations, accessed 3/24/11.