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Abstract

Since social entrepreneurship is a relatively young activity, resource-rich actors, like Philanthropic VCs, have considerable influence over how the space matures (Nicholls, 2010b). The resources and strategic advice that PhVCs provide their SEs shape an institutional logic for the domain. As such, PhVCs enhance legitimacy of the emerging area of social entrepreneurship. This monograph's main contribution is to delineate the current state of PhVC, identifying differences with traditional VC financing, and identify areas of future research. In particular, this work responds to Nicholls (2010b) and Austin et al.'s (2006b) call for research on what types of finance SEs have access to. More specifically, we focus on understanding what PhVC is and how its social value creation investment logic makes it different from traditional VC, opening avenues for future research in this area.

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1

Introduction

Philanthropic venture capital (PhVC) is an innovative funding model available for social enterprises (SEs) which provides a blend of performance-based development finance and professional services to organisations with a primary social mission. PhVC seeks to maximize the social impact of the investee through the provision of capital and value-added activities, as typically done in traditional venture capital (VC) financing. The main difference between PhVC and traditional VC lies in the investment goals. Whereas traditional venture capitalists (VCs) work to grow each of their portfolio companies and ultimately seek a large financial return upon a liquidity event (most often an Initial Public Offering [IPO] or acquisition), PhVC have both economic and social goals. Specifically, philanthropic venture capitalists (PhVCs) work to develop self-sustaining SEs assuming that sustainability facilitates long-term organizational survival, growth and ultimately maximization of their impact on society (Letts et al., 1997).

The importance of SEs has been growing both in the professional and academic sectors over the last decade (Bosma and Levie, 2010; Harding, 2007, 2004; Roberts and Woods, 2005). In particular, Bosma and Levie (2010) report the average rate of social entrepreneurial activity across the countries participating in the Global Entrepreneurship Monitor amounts to 1.8 percent of the total adult population; within the United Kingdom, Harding (2007) reports that the rate was 3.3 percent in 2006. While explaining social entrepreneurship trends, Cox and Healey (1998) indicate that in Europe, SEs have a key role in welfare and environmental policy innovation, whereas Mair and Seelos (2007) as well as Prahalad (2006) argue that in developing countries, social entrepreneurship tends to address compelling social problems, such as hunger, disease and education, through the application of innovative and cost-effective methods to traditional solutions. At the research level, Short et al. (2009) show that the publication rate of research articles on social entrepreneurship, subject to a double-blinded review process, has increased by 750 percent between 1991 and 2009.

On the academic side, the bulk of research has sought to define what an SE is and how it differs from traditional commercial ventures. In doing so, social entrepreneurship has been presented as a new model of systemic social change (Bornstein, 2004; Nicholls, 2010b), the solution to government failures in welfare provision (Aiken, 2006; Bovaird, 2006), a new market opportunity for business (Prahalad, 2006), a model of political transformation and empowerment (Alvord et al., 2004), and a space for new hybrid partnerships (Austin et al., 2006a).

Despite the growing importance, SEs still struggle to secure external sources of finance. SEs must deal with the Pareto assumption that achieving a social and/or environmental return inevitably reduces economic returns for investors. Financial economists suggest that investments can only be differentiated based on their risk-return profile with social or environmental factors being presented as externalities (Arrow and Fisher, 1974; Freidman, 1962). This, in turn, leaves no room in that research sphere for the existence of investments in organizations with social aims, such as SEs. Also, the inability to get financing might constitute the single biggest barrier to establishing an SE (Bank of England, 2003). Other research also finds that access to finance is the main barrier to SEs' growth (Harding, 2007; Smallbone et al., 2001; Conaty, 2001).

PhVC helps overcome the financing access problem, because it combines a for-profit focus on efficient use of economic resources with the nonprofit proposition on social value creation (Austin et al., 2006a). Rather than providing funds to single projects with a short-term investment period, as typically done by foundations or government grants, PhVC commits to long-term funding in order to build the capacity of the SE to become sustainable, grow, and ultimately maximize its social impact. However, the mere provision of capital is not enough for sustainability and growth; financial resources must be accompanied by the provision of value added activities and a high level of PhVC strategic engagement. For instance, PhVCs typically sit on the board of the SEs they back and advise the entrepreneurs on how to grow.

Since social entrepreneurship is a relatively young activity, resource-rich actors, like PhVCs, have considerable influence over how the space matures (Nicholls, 2010b). The resources and strategic advice that PhVCs provide their SEs shape an institutional logic for the domain. As such, PhVCs enhance legitimacy of the emerging area of social entrepreneurship. This monograph's main contribution is to delineate the current state of PhVC, identifying differences with traditional VC financing, and identify areas of future research. In particular, this work responds to Nicholls (2010b) and Austin et al.'s (2006b) call for research on what types of finance SEs have access to. More specifically, we focus on understanding what PhVC is and how its social value creation investment logic makes it different from traditional VC, opening avenues for future research in this area. We do not cover how PhVCs raise their funds as we are interested in the relationship between the philanthropic investor and the SE.

The monograph is structured as follows. First, a definition of PhVC is proposed. Second, an overview of financing available for social entrepreneurs is discussed focusing on those characterized by a level of investor engagement. Third, data on the PhVC sector in the United States and in Europe is presented in terms of age of the sector, legal form of the PhVC firm, capital under management and location of portfolio organizations. Forth, investment practices implemented in PhVC are identified according to the different phases of the investment process in traditional VC and further research opportunities are identified. Last, the paper draws conclusions and implications for academics and practitioners.

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