



Financing Social Enterprise

HBS Business Plan Contest & Social Enterprise Club

Michael Chu – February 20, 2007

SOCIAL ENTERPRISE

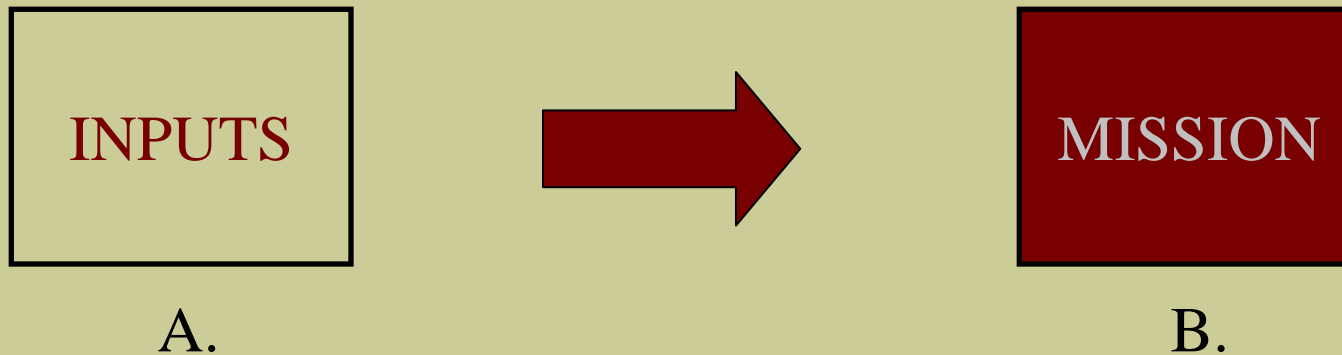
An enterprise that has **social impact** as a principal component of its activity

- Non-Profit
- For-Profit
- Public Sector

Because of this **social mission**, it is an enterprise different than a conventional commercial entity:

- SE BP Contest focuses on this **mission**

WHAT IS A SE BUSINESS PLAN?

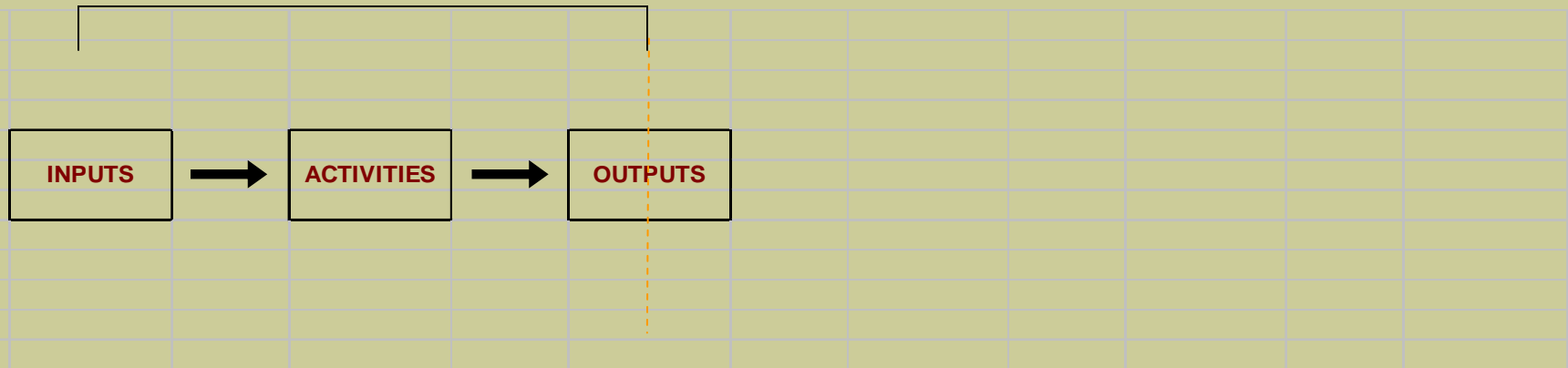


How to get from A to B

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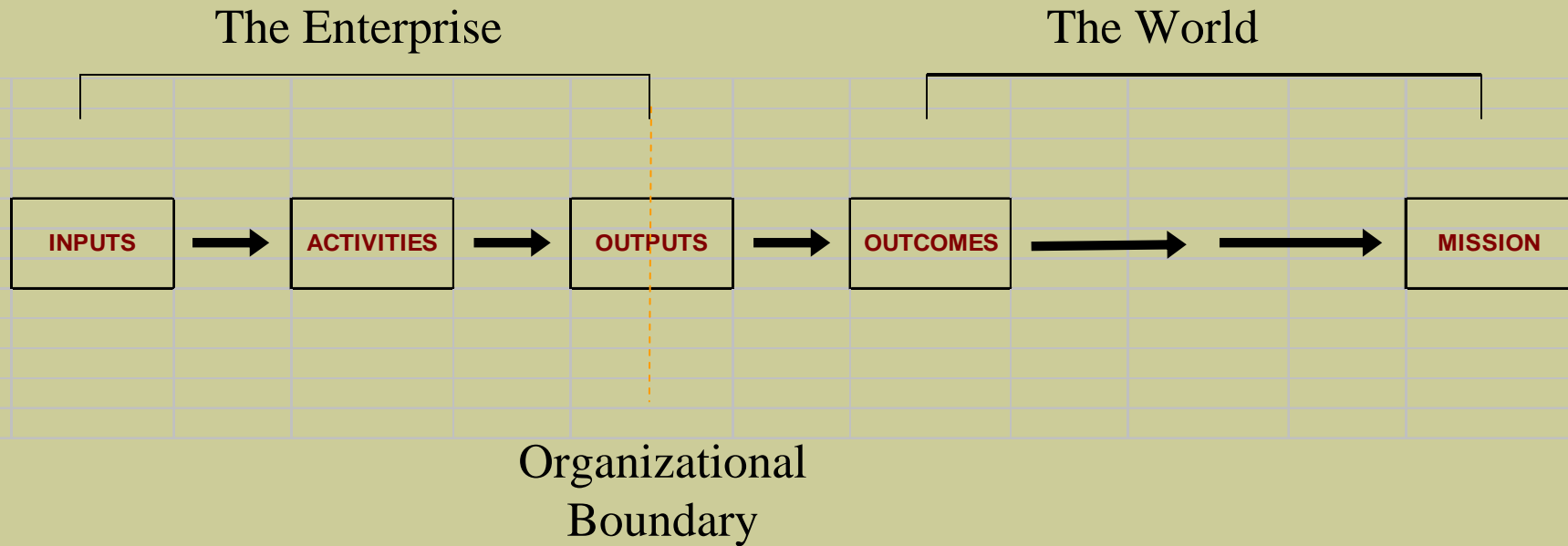
BUSINESS PLAN: YOUR ENTERPRISE

The Enterprise



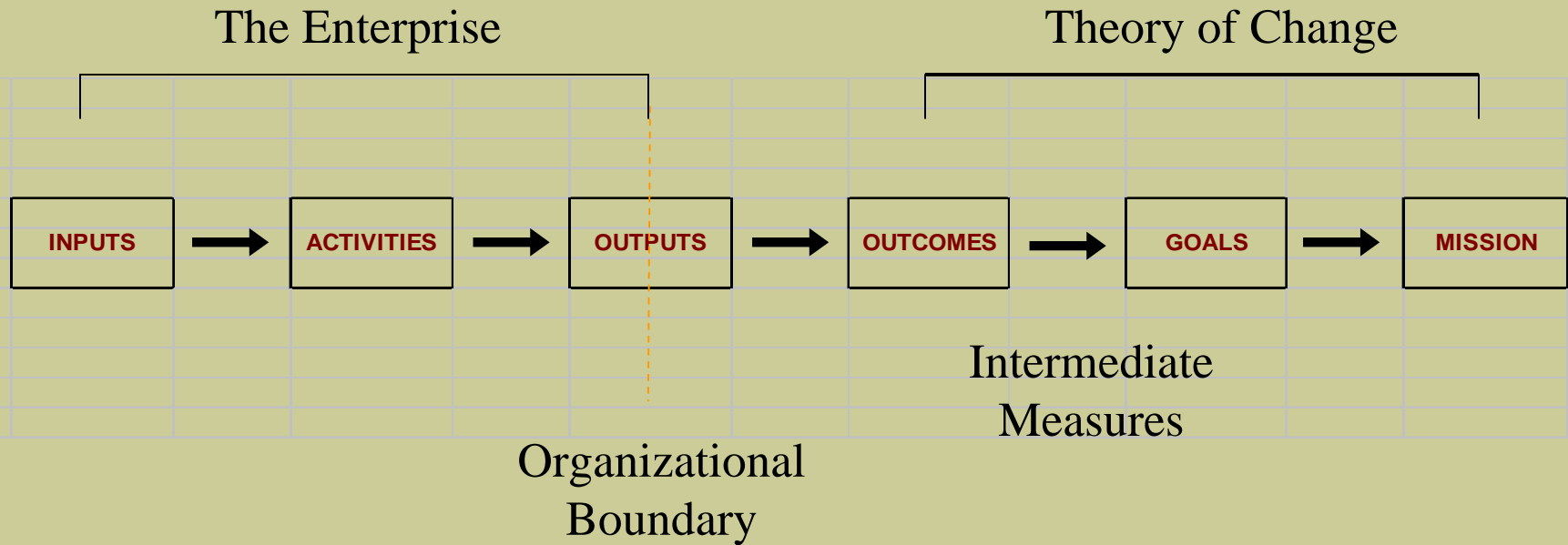
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YOUR ENTERPRISE & THE WORLD



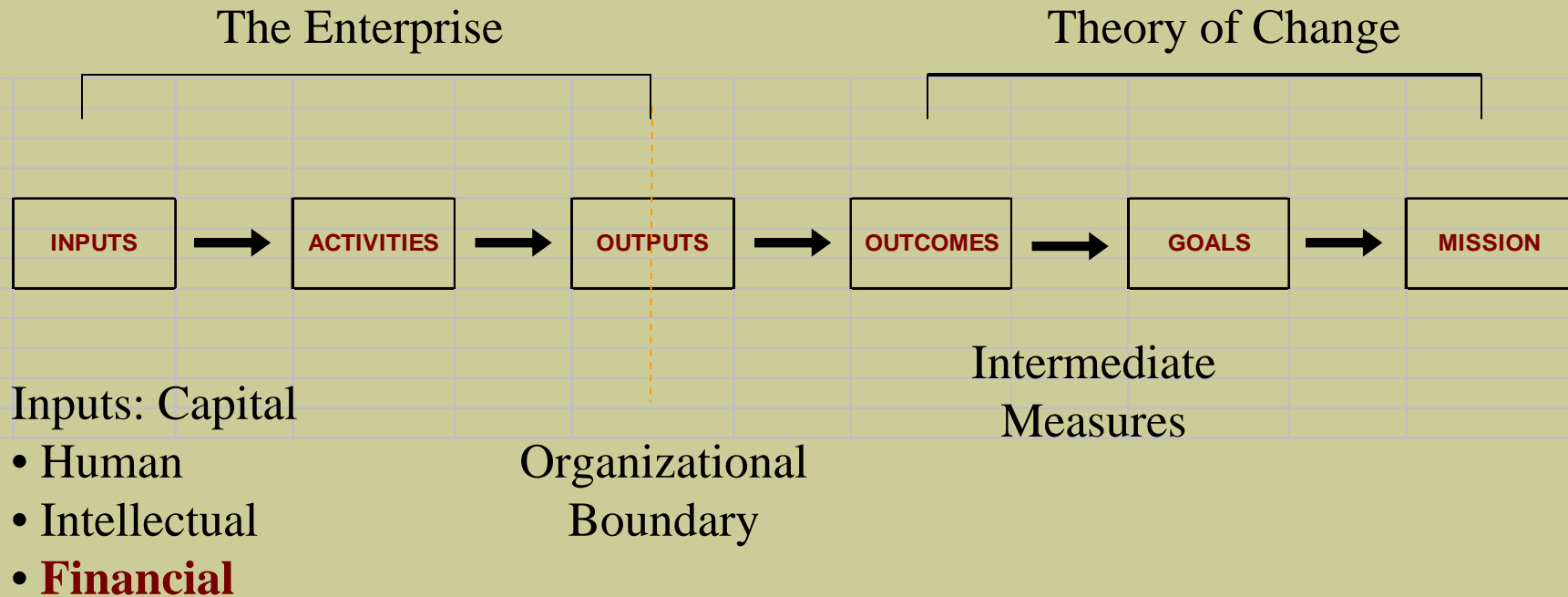
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YOUR THEORY OF CHANGE



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FINANCING THE BUSINESS PLAN



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THE FINANCIAL MODEL OF A SE

All social enterprises have financial statements:

- Statement of Income
- Balance Sheet
- Cash Flow

...whether non-profit or for-profit.

All have **expenses**

All have the same basic **revenue** questions:

- How do I fund start-up? ➡ Proof of concept
- How do I fund growth? ➡ Scale
- How do I fund sustainability? ➡ Survival / time

Where that revenue comes from will differ

NON-PROFIT OR FOR-PROFIT?

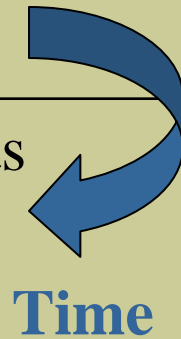
FINANCIAL PROFILE	CHOICE OF S.E.
<ul style="list-style-type: none">• Little or no revenues from activities = Revenue < Costs• Earned income, but Total Revenues < Costs	<p>Non-Profit</p> <p><u>Model</u>: Social Value > Economic Value</p>

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<ul style="list-style-type: none">• Earned income > Costs	<p>For-Profit</p> <p><u>Model</u>: Economic Value >= Social Value</p>

NON-PROFIT INTO FOR-PROFIT

FINANCIAL PROFILE	CHOICE OF S.E.
<ul style="list-style-type: none"> • Little or no revenues from activities = Revenue < Costs • Earned income, but Total Revenues < Costs 	<p>Non-Profit</p> <p>Proof of Concept & Pilot</p> <p><u>Model</u>: Social Value > Economic Value</p>
<ul style="list-style-type: none"> • Earned income > Costs 	<p>For-Profit</p> <p>Operational Model</p> <p><u>Model</u>: Economic Value >= Social Value</p>



SE for-profits may begin as non-profits

FINANCING SOURCES: THE NON-PROFIT SE

Organization Stage	Sources	Comments
• Start-up	• Philanthropy	
• Growth	• PRIs (Foundations)	
• Sustaining	• Government • U.S. and/or International Agencies • Contributions • Fees for service	

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FINANCING SOURCES: THE NON-PROFIT SE

Organization Stage	Sources	Comments
• Start-up	• Philanthropy	<ul style="list-style-type: none"> • Sustainability: key • Surpluses: +++ • Caveat: Earned income: Tail wag the dog? • Caveat: SE capital markets \neq financial capital markets
• Growth	• PRIs (Foundations)	
• Sustaining	<ul style="list-style-type: none"> • Government • U.S. and/or International Agencies • Contributions • Fees for service 	

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THE FOR-PROFIT SE: MARKET MODEL

Business Characteristics	Organizational Stages	Traditional Capital Sources
<ul style="list-style-type: none"> • Capable of Market Rate of Return (ROS, ROA, ROE) • Liquidity Event possible 	<ul style="list-style-type: none"> • Start-up • Growth • Sustaining 	<ul style="list-style-type: none"> • Angels • Venture Capital • Private Equity • Capital Markets

Examples: Princeton Review, Edison

FOR PROFIT SE: NON-MARKET MODEL

Business Characteristics	Organizational Stages	Traditional Capital Sources
<ul style="list-style-type: none"> • Below Market Rate of Return (ROS, ROA, ROE) • Unproven Financial Model • Liquidity Event questionable 	<ul style="list-style-type: none"> • Start-up • Growth • Sustaining 	<ul style="list-style-type: none"> • Venture Philanthropy • PRIs • Social Investors • Hybrid Funds • Community development funds

Examples of funds: New School Ventures Fund, Investors Circle

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SE BUTTERFLY: FROM NON TO FOR-PROFIT

Example: Commercial Microfinance

Organizational Stages	Type of Organization	Financing Sources
<ul style="list-style-type: none">• Start-up	<ul style="list-style-type: none">• Non-Profit	<ul style="list-style-type: none">• Philanthropy, US & International Agencies
<ul style="list-style-type: none">• Initial Growth	<ul style="list-style-type: none">• Non-Profit \geq Break-even	<ul style="list-style-type: none">• Commercial Banks
<ul style="list-style-type: none">• Subsequent Growth	<ul style="list-style-type: none">• For-Profit	<ul style="list-style-type: none">• Capital Markets

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FINANCIAL RETURNS & SOCIAL VALUE

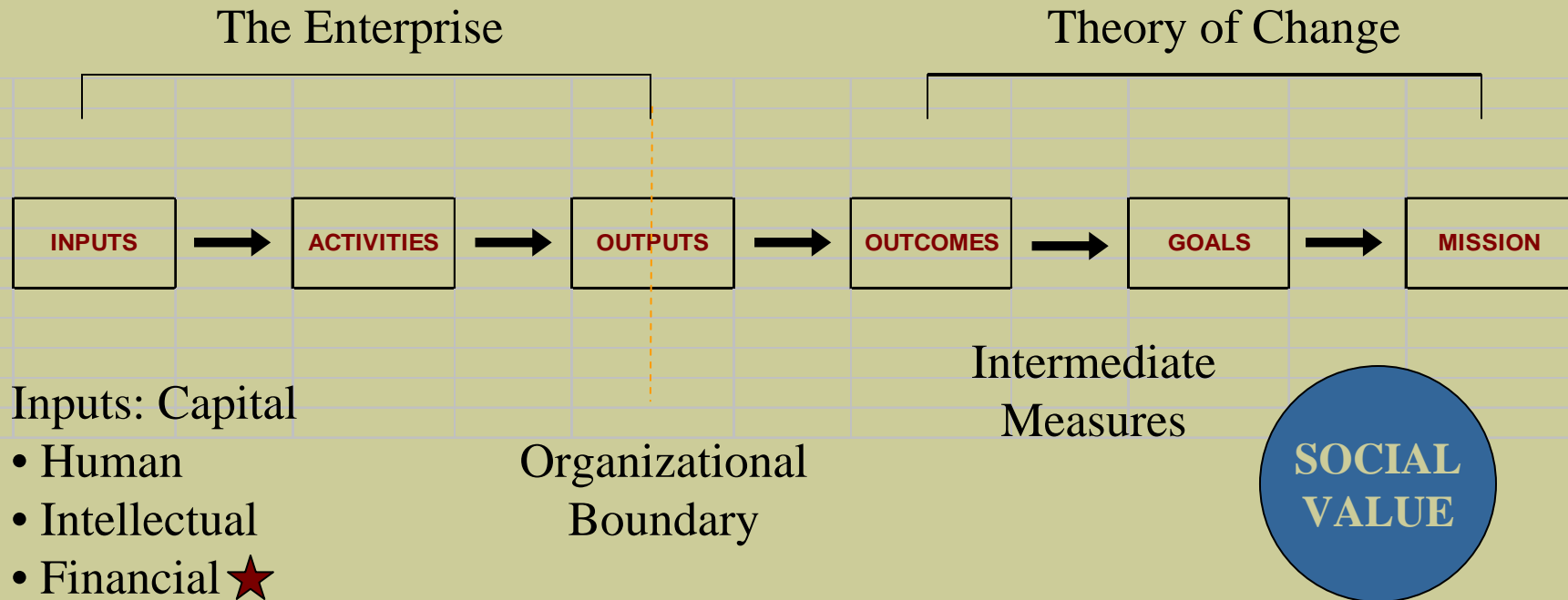
Low tension

- FR and SV creation coexist in harmony
 - College Coach
 - Modulo

High tension

- FR and SV creation in constant tension (economically, politically or both)
 - HMOs, EMOs
 - Microfinance

THE FULL BUSINESS PLAN



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DEFINING SOCIAL VALUE

Social need exists

- Size
- Importance

Theory of Change

- Cause and Effect

Mission

- Actionable
- Measurable

SOCIAL ENTERPRISE CAPITAL MARKETS

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2007

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COMMERCIAL CAPITAL MARKETS

CAPITAL SEEKING DEPLOYMENT			
<ul style="list-style-type: none">• Highest return• At given level of risk			
INSTITUTIONS		INDIVIDUALS	
PRIVATE	PUBLIC	HIGH NET WORTH	GENERAL

END USERS OF CAPITAL	
START-UPS	ESTABLISHED COMPANIES

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SOCIAL ENTERPRISE CAPITAL MARKETS

SOURCES OF PHILANTHROPY			
INDIVIDUALS	FOUNDATIONS	BEQUESTS	COMPANIES

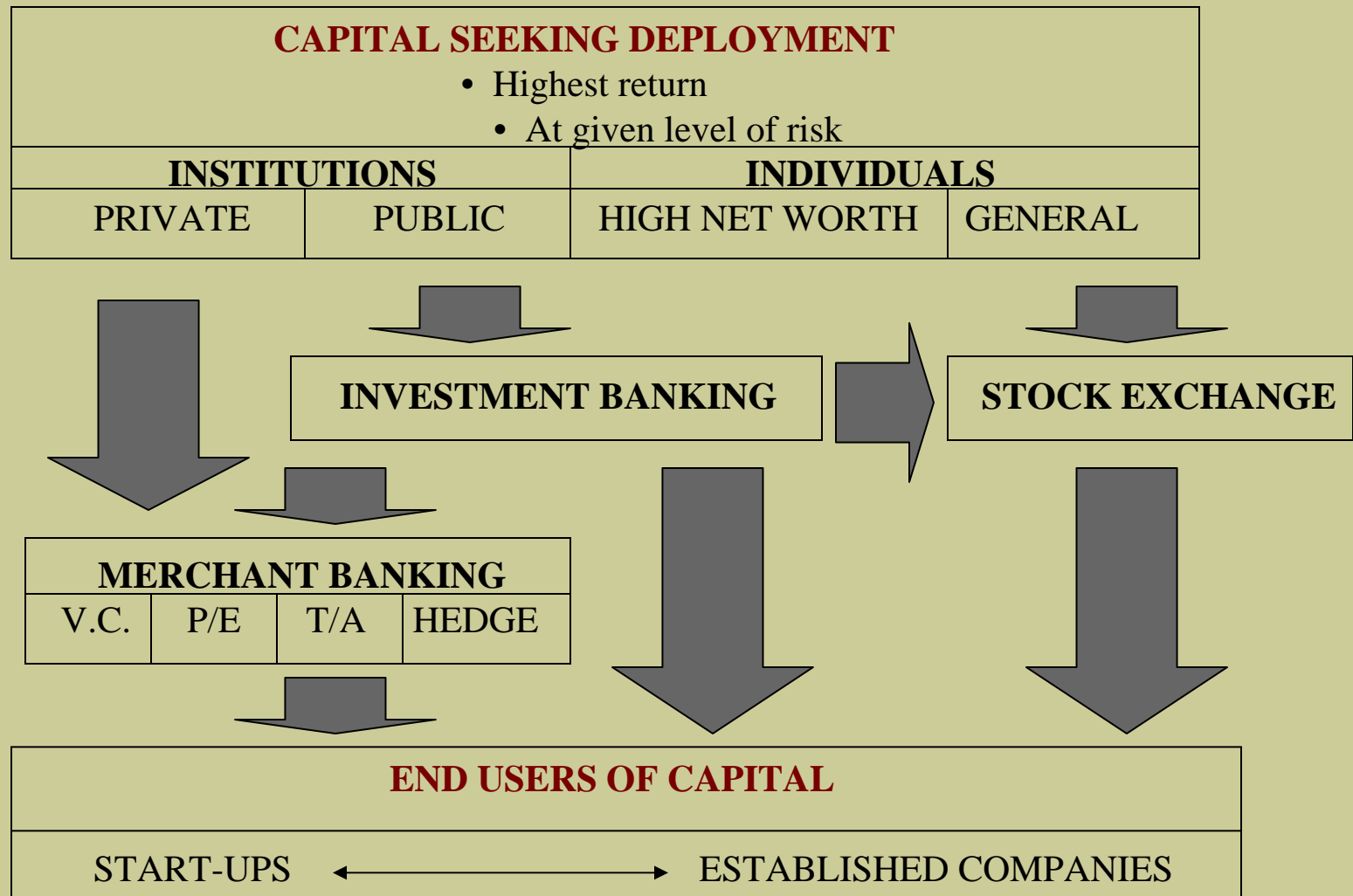
USERS OF PHILANTHROPY	
START-UPS	MEGA ORGANIZATIONS
LOCAL	GLOBAL
ONE SITE	MULTI-SITE
SINGLE FOCUS	MULTIPLE ACTIVITIES

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MARKET EFFICIENCY

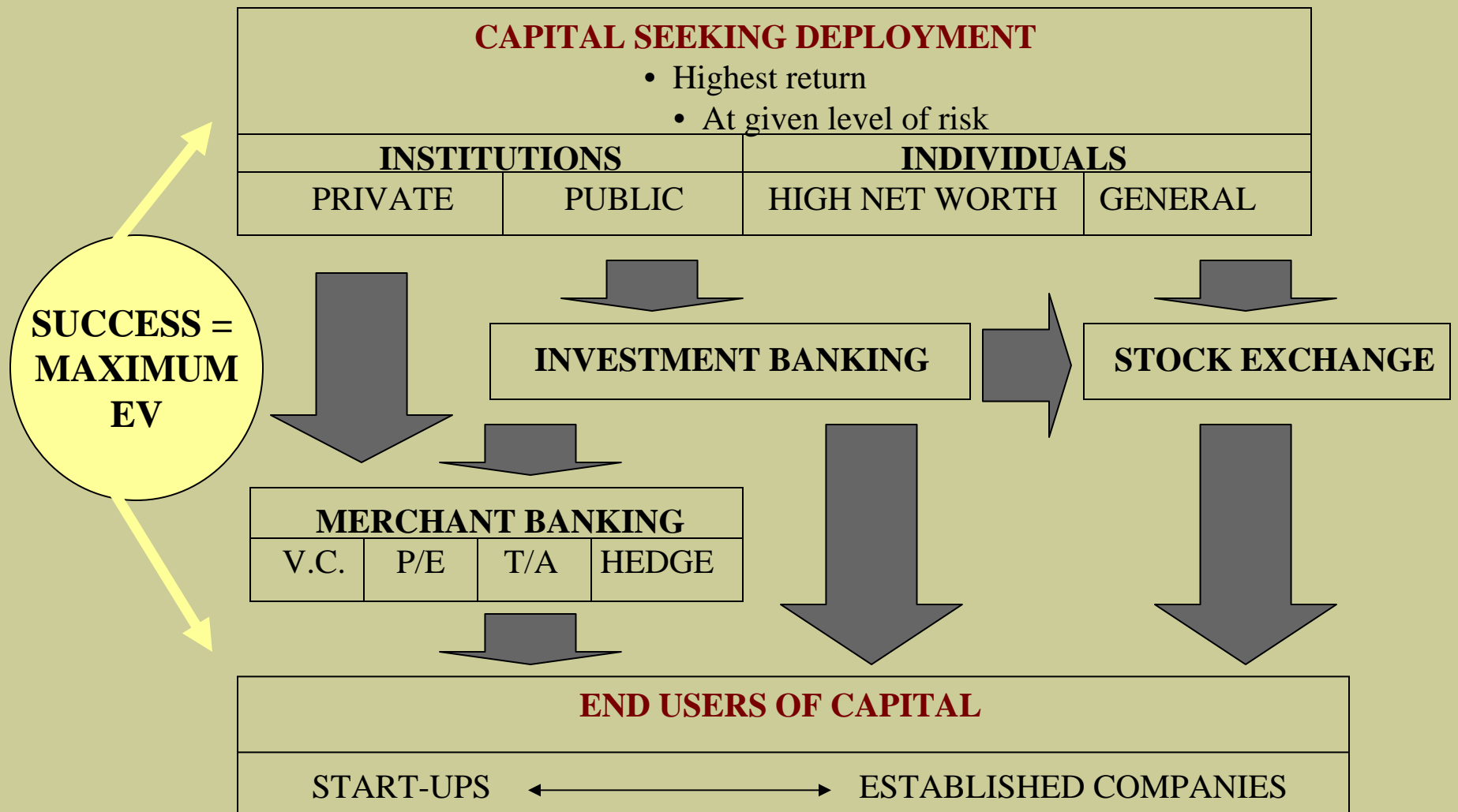
- Clear definition of SUCCESS
- Clear measurement of SUCCESS
- Clear rewarding of SUCCESS
- Infrastructure to implement all the above

COMMERCIAL CAPITAL MARKETS



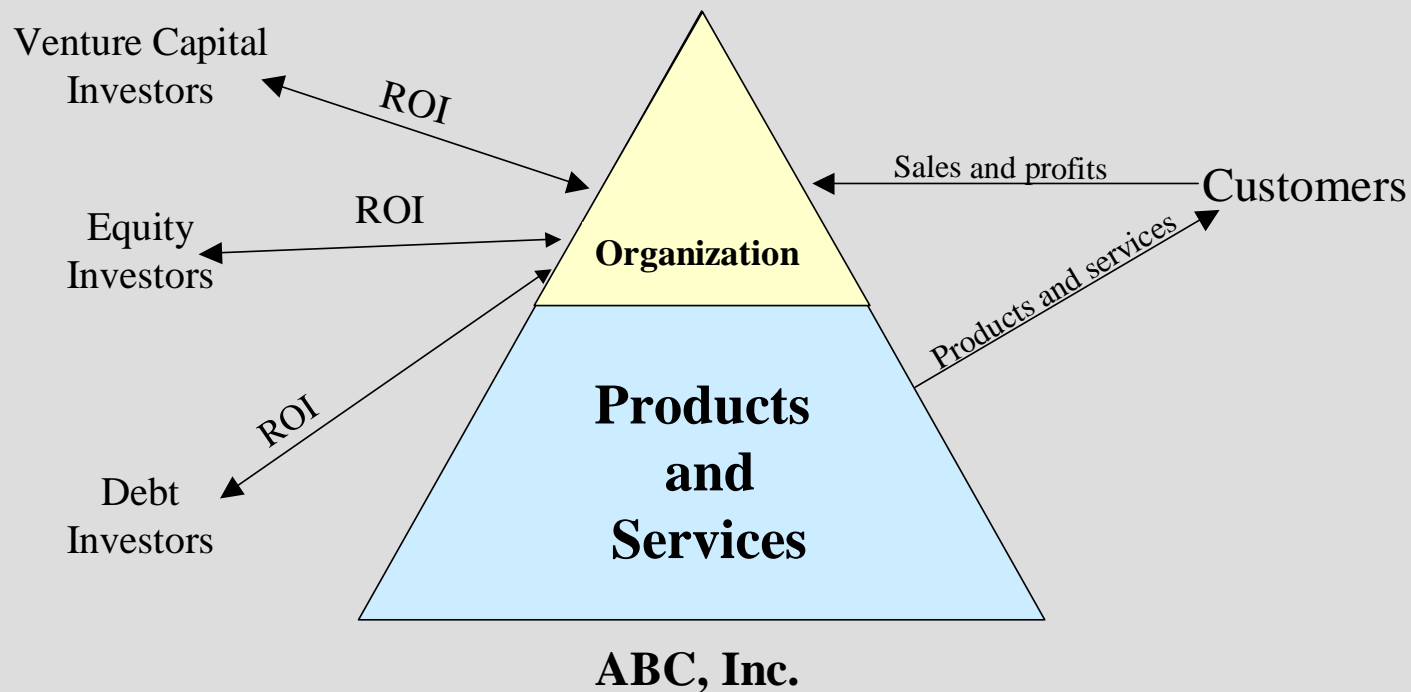
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COMMERCIAL CAPITAL MARKETS



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FOR PROFIT CAPITAL MARKET STRUCTURE

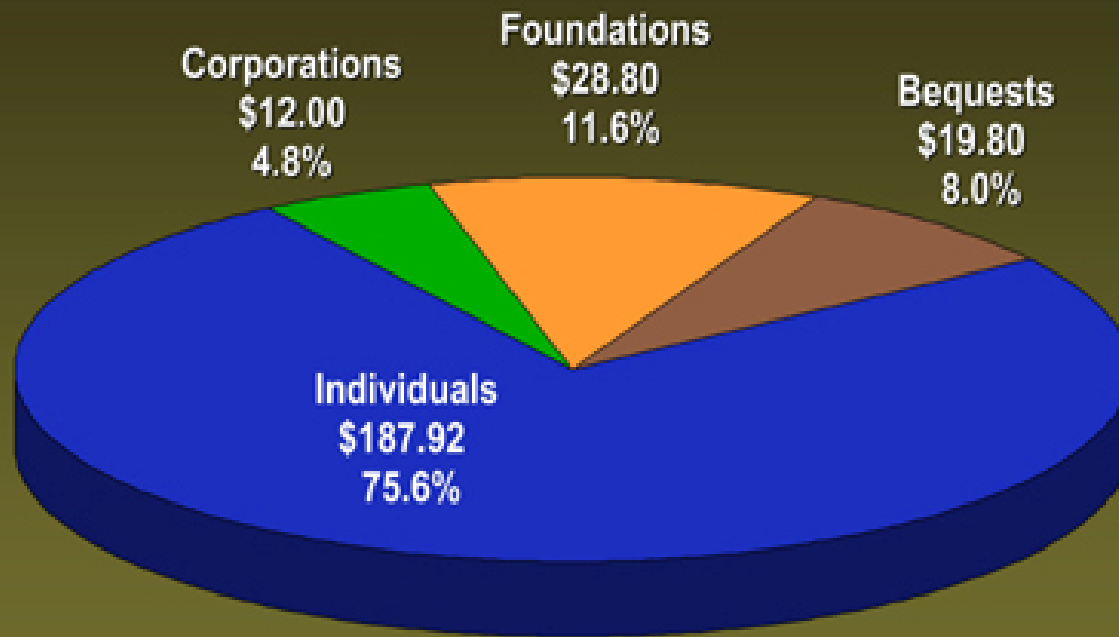


The greater the corporation's ability to cost-effectively satisfy the customers' needs > Sales and profit > Availability of funds.

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SE CONTRIBUTIONS BY SOURCE

2004 CONTRIBUTIONS: \$248.52 BILLION BY SOURCE OF CONTRIBUTIONS

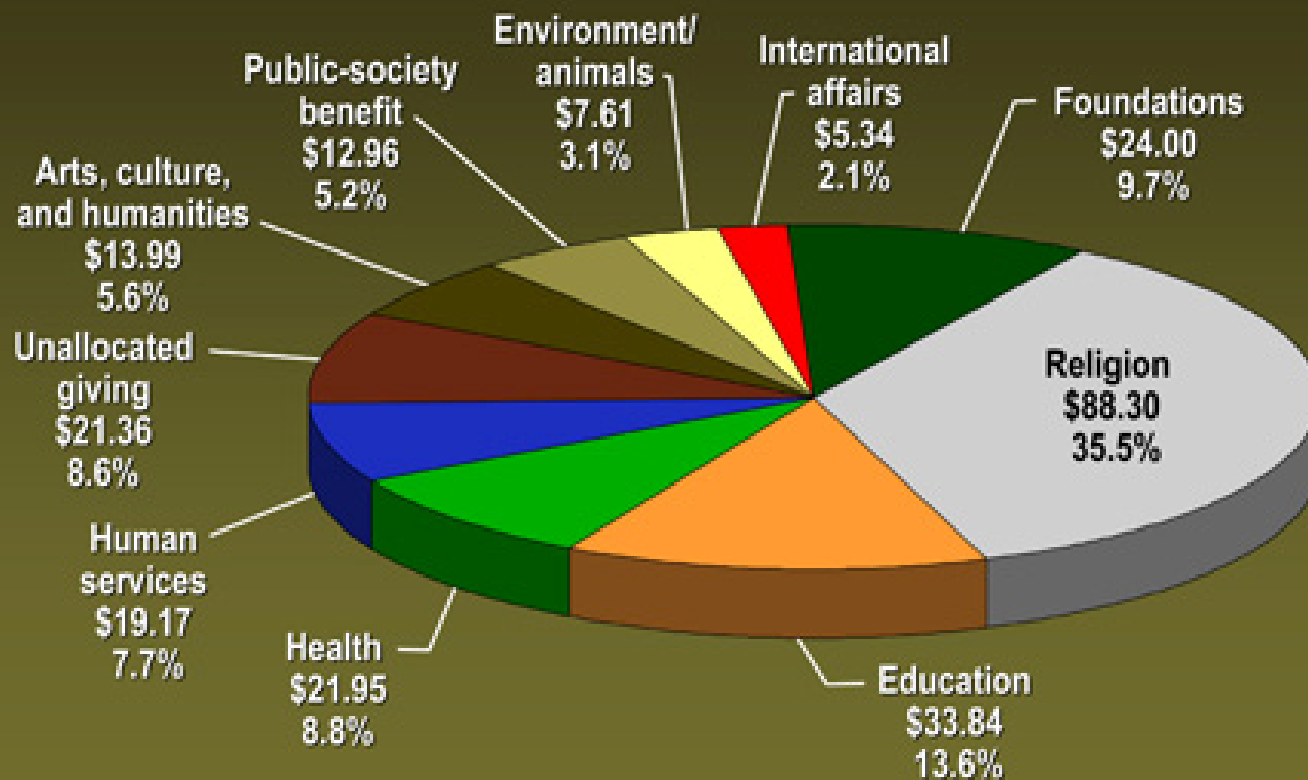


Source: Giving USA Foundation™ – AAFRC Trust for Philanthropy/Giving USA 2005

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SE CONTRIBUTIONS BY RECIPIENT

2004 CONTRIBUTIONS: \$248.52 BILLION BY TYPE OF RECIPIENT

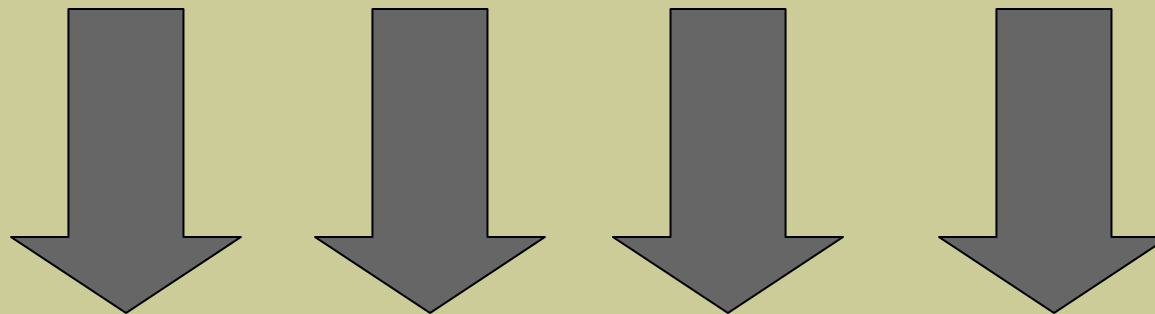


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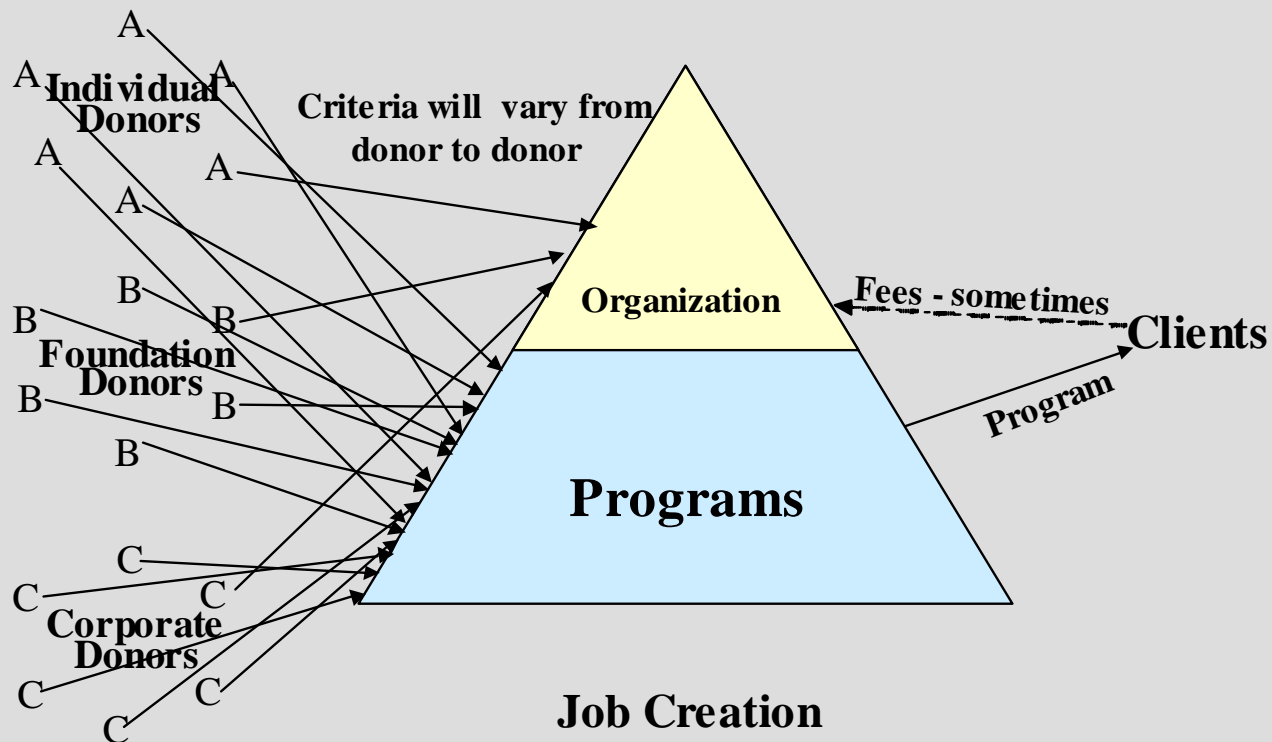
SOURCES OF PHILANTHROPY			
INDIVIDUALS	FOUNDATIONS	BEQUESTS	COMPANIES



USERS OF PHILANTHROPY	
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PHILANTHROPIC CAPITAL MARKET STRUCTURE



The greater the nonprofit organization's ability to cost-effectively serve the clients' needs ??? Revenue ??? Availability of funds

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PERFORMANCE DRIVEN PHILANTHROPY

A Model for Change

<u>FEATURE</u>	<u>VENTURE CAPITAL</u>	<u>CONVENTIONAL FOUNDATIONS</u>	<u>PERFORMANCE DRIVEN PHILANTHROPY</u>
TYPE	ORGANZATIONAL	MOSTLY TO PROGRAMS	ORGANIZATIONAL
DEGREE OF FUNDING	SUBSTANTIAL - COMMITMENT TO RAISE NECESSARY CAPTIAL	ARBITRARY - NO COMMITMENT TO HELP	SUBSTANTIAL – COMMITMENT TO HELP RAISE CAPITAL
DURATION	5-7 YEARS LINKED TO SUCCESS	85% 1 YEAR ARBITRARY CRITERIA TO CONTINUE	3-5 YEARS LINKED TO SUCCESS
TERMS OF ENGAGEMENT	PARTNERSHIP MANAGEMENT SUPPORT	ARMS LENGTH - OVERSIGHT MONEY ONLY	PARTNERSHIP TECHNICAL AND MANAGEMENT SUPPORT
RESULTS	2 STARS; 2 FAILURES 6 WALKING DEAD OR WOUNDED	SUPERFICIAL TRACKING NO REPORTING OF RESULTS	WILL BE TRACKED
	EFFECTIVENESS OF CAPITAL MEASURED	EFFECTIVENESS OF CAPITAL NOT MEASURED	EFFECTIVENESS OF CAPITAL WILL BE MEASURED

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PERFORMANCE DRIVEN PHILANTHROPY

A Model for Change

<u>FEATURE</u>	<u>VENTURE CAPITAL</u>	<u>CONVENTIONAL PHILANTHROPY</u>	<u>PERFORMANCE DRIVEN PHILANTHROPY</u>
PERFORMANCE INDICATORS	CLEARLY DEFINED REWARDS AND RISKS FOR ALL	LITTLE CLARITY - NONPROFIT BEARS MOST RISK	CLEARLY DEFINED – RISK OF FAILURE SHARED
PACE	“NEVER SUCCEED ON ORIGINAL STRATEGY”	MID-COURSE CORRECTIONS NOT ACCEPTED AS GIVEN	“NEVER SUCCEED ON ORIGINAL STRATEGY”
	ADAPTATION AND AGILITY; RESPONDS TO MARKET	RIGID; BIASED BY BOARD MEETING SCHEDULE	ADAPTATION AND AGLITY; RESPONDS TO MARKET
EXIT STRATEGY	SINGLE-MINDED FOCUS LINKED TO CHANCES FOR SUSTAINED SUCCESS	“MYTH” OF GOVERNMENT TAKE OUT BURDEN ON NONPROFITS	PARTNER WITH NONPROFIT TO ADDRESS CHALLENGE

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IMPLICATIONS FOR SE

- Success in your organization's goals is no guarantee of funding
- Shakeouts rarely occur
 - Economic viability not relevant
 - Efficiency & efficacy not equal to reward
- Just because you are better than others does not mean you get more funds
- High inefficiency in raising capital
- Serve various masters:
 - Your mission's target population
 - Your funders
 - No guarantee of alignment
 - mission with funders
 - funders with funders

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MANAGEMENT RESPONSE

- Know your own critical path: must dos for mission
 - Theory of change
 - Link performance to theory of change
 - Measure performance
- Know when to say NO
 - The most expensive money is the dollar that makes you step off your critical path