



Access to capital for social enterprises. What are the challenges?

In the past two months, I had the privilege of participating in various meetings in Sao Paulo, Mexico City, Buenos Aires, where social entrepreneurs and potential investors in social business-[Vox Capital](#), [Ventura Institute](#), [JJPartners](#), [Kellogg Foundation](#) , [Ignia Fund](#) , Banco Columbia, among others, discussed about social investment. While individuals and organizations were different in each session, it is not a surprise that when we talk about investment in social enterprises in Latin America, more or less the same questions, arguments and tensions between entrepreneurs and potential investors arise.

Some of them are: What is the financial return we should expect from a social business? If we talk about 30-40%, are we facing a social or a traditional business? Shouldn't social businesses have a lower return? Other voices are even more radical: should a social business pay dividends? Or not? If we consider governance: how is the governance model of a social business that has 50% shareholding of a foreign investor? Will it be possible in this context to continue to take into consideration the voices of every other minor stakeholder in the social business? Will it be participatory, inclusive enough? Should external participation limits be installed to avoid control issues and ensure that the social mission of the business is guaranteed? Once agreement has been made over the level of participation, what mechanisms do we use to establish the valuation of the social enterprise? Will we use IRR, NPV or some other traditional financial indicator only, or will we also include variables to measure the social capital that the social enterprise is bringing to the merger, its networks, its knowledge, its effective capacity to deliver services and products to benefit low income communities? Which would these indicators be?

Certainly, the answer to these questions is not easy, neither do they have a unique one, because both from the investors side and from the social entrepreneurs, the range of actors that is emerging is wide and diverse. As we shall see, not all investors in social business have the same objectives when investing in this field or are willing to assume the same level of risk - while some seek only to recover their capital, others seek profit-. The same applies to the social enterprises: some are willing to distribute dividends to external investors and others aren't; some are willing to trade a portion of the ownership of the enterprise, or levels of decision making, and others aren't. And we could go. Starting to recognize these differences is key to unlocking the different possibilities of this market, as well as to start building an effective ecosystem for the social business to grow.

Here are some specific issues.

Volume of available funding: There is a gap between the average requirement of capital for most of the social business in Latin America -between 50 thousand and 500 thousand dollars, approximately-, and the minimum offered by venture capital funds as Ignia Fund or the Kellogg Foundation, to name a few. And if entrepreneurs argue that "it is easier to get 2 million than 70 thousand dollars", representatives of funds, such as Alejandro Villanueva from Kellogg Foundation, say "we have not found too many organizations in Latin America that can receive an investment of USD 2 million, and for us to invest USD 200 thousand represents high operation costs that we cannot afford. Yet we must find a way to do it in a not so expensive way". A lead in this issue could be to try a syndication or, in other words, "that an organization could aggregate the demand of 10 social businesses that need USD 100,000 each, and act as a sort of intermediary", as proposed by Ashoka Fellow Rodrigo Britto from Alianza Emprendedora. Or we could think on some kind of platform that could lower the costs of evaluation and operation of social venture capital funds.

Different types of investors with different risk tolerance. In general terms, we might divide social investors in two types: the one who invests in a social enterprise because he seeks profit with social impact, and the one who cares about recovering capital only, because he believes his return is already implicit in the social impact of business. Daniel González, from Avina, says that for him there are three categories: **profit-seeking investor** –looks for returns similar to a traditional business-, **return-seeking investor** –seeks for returns that are lower to market ones, up to 10 % -, and **non-profit investor**. All these types of investors are part of a market of social capital that is required for the different stages of a social business. Alvaro Rodríguez, from Ignia Fund, says that "the key is to stop focusing on profitability and return; we need to begin to talk about the investor's tolerance to risk". He developed an interesting chart with the different levels of risk a social business has -depending on their stage, or industry in which they are-, explaining that "in terms of risk level, Ignia Fund is positioned a step before the traditional venture capital funds. Higher risk investments in social businesses should be made by investors who do not seek profit, but social return, or even by donor foundations. This is an important role that traditional foundations should play in this market: mitigating the risk of the investment". An important point, which may be obvious but is not always considered, is that the level of risk of the social business needs to be very clear. From the entrepreneurs side, this will help them know which investor best suits their needs. From the investors' side, this will facilitate their decision making based on the level of risk they are willing to take.

Various financial tools, depending on the stage where social enterprise is: social enterprises have different organizational models, and are at various stages, ranging from start-up until the expansion. This diversity of situations requires a wide flexibility in the financial mechanisms of capital supply - combinations of grants, patient capital, soft loans, equity, mezzanine. While there are investors who are creatively muscling in such combination of financial mechanisms, as [Instituto Ventura or Fondo Inversor](#), still there is a long way to go in this field, and the most appropriate financial structure for each business should be better understood both by funders and by the entrepreneurs themselves.

The dilemma of ownership and decision making: While some funds as Ignia buy 50% of a social enterprise, others, such as Fondo Inversor, have a policy to never invest more than the 25% of the business to avoid having a very high share. This situation, quite valid from the investment side, is often seen as a risk by the entrepreneurs, especially when the question of government arises: how will the decision making process be settled under this new scheme, how can the social mission of the business can be guaranteed over the profit maximization? Other issue related to the participation of an external investor is the "exit strategy", since many entrepreneurs are clear about their lack of interest in selling the social business. Once again, the key is to have enough clarity about all these questions and be able to negotiate from the beginning of the relationship with the potential investor. Everyone has to be clear about what he is giving and what he is receiving and at what cost. Last week I was chatting with an entrepreneur who suspended negotiations with a social fund with strong interest in investing in his social business because while he was looking for capital to improve the quality of the product, the investor conditioned the investment to the improvement of the commercial strategy. In relation to this issue, a different model is being developed by Ashoka Fellow Sergio Oceransky, from [Yansa Group](#), a social enterprise that will produce wind turbines for rural communities so they can manage energy renewable resources. Yansa's funding source will come from two investment funds that they themselves are creating -one of high risk and the other of near zero-risk- in which external investors will not participate in the business decision making process.

Know-how transfer: Usually investors offer, together with capital, high quality advice and added value to enrich the social business management. This is the case of Vox Capital. This resource is highly valued by entrepreneurs, as it incorporates to their teams specific skills that enable the business to scale up. But, one of the questions that arise here is that knowledge transfer should be done in the opposite direction as well: social business could influence in the social funds with their knowledge on approaches for poverty reduction. This would actually be a change of paradigm.

The valuation of a social enterprise. I already mentioned this before, but it is important enough to bring it back. Rodrigo Vieira, of [Electrocooperativa](#) raised a very interesting question "In my experience as a private entrepreneur, one of the main causes of tension between the entrepreneur and the investor is the moment of negotiation of the valuation of the company, which obviously is always higher in the entrepreneur's view, and lower in the investors view. In the case of social enterprises, which valuation mechanisms are we thinking of? In addition to economic indicators, which other mechanisms are we going to use to measure our networks, our knowledge in addressing poverty or including the currently excluded communities, the vast social capital without which no social change is possible?". Without doubt, creating these indicators is a pending issue which would contribute a great deal to facilitate the dialogue between investors and entrepreneurs. Some methodologies have already been created, as the SROI, but often their high cost makes implementation impractical. We believe that at this point, the role of academia is essential to rely on the construction of indicators or parameters that can define standards.

Again, we have more dilemmas than answers. Many investment funds operating in Latin America have yet to gain experience in the investment on social business. Quoting Alvaro Rodríguez again "if to fight poverty we need a toolbox, this is just one tool." However, I believe that this kind of dialogues and meetings are key to enable investors to understand the needs and expectations of entrepreneurs-and vice versa, and together we can continue to building a social capital market that can accurately help scale up models in a way that is effective to generate more and better opportunities for communities that are now excluded.

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