Funding Social Ventures

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Learning Objectives

- To gain an understanding of the challenges social entrepreneurs encounter when raising capital for their social venture
- To examine the questions about the financial drivers of an enterprise that can help direct the social entrepreneur to the appropriate capital sources
- To gain an awareness of the intentions of investors across the social capital market
- To learn about the role and appreciation of values and mission alignment with investors
- To investigate the impact investing market and its categories
- To gain an understanding of the challenges social entrepreneurs encounter when raising capital for their social venture
- To introduce the investment decision and due diligence process of social investors
- To learn how to build partnerships with investors in order to create impact

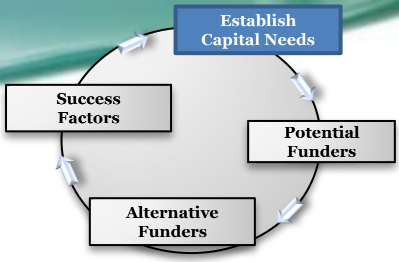
Funding Cycle

Establish Capital Needs
Determine how much you *really* need

Potential Funders
Identify possible funders

Alternative Funders
Angels, Venture philanthropy, Impact, Crowdfunding

Success Factors
Getting to YES!



Establish Capital Needs:
What do new ventures really need?

Cash Flow Challenges

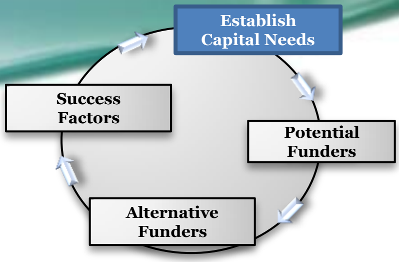
Inventory must be purchased, employees must be trained and paid, and advertising must be paid for before cash is generated from sales

Capital Investments

The cost of buying real estate, building facilities, and purchasing equipment typically exceeds a firm's ability to provide funds for these needs on its own

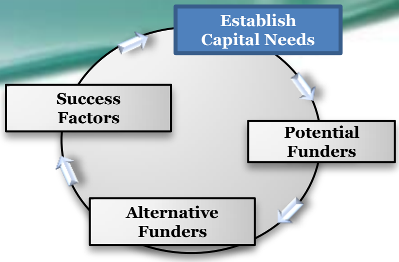
Product Development Cycles

Some products are under development for years before they generate earnings, with up-front costs often exceeding the firm's ability to fund these activities on its own



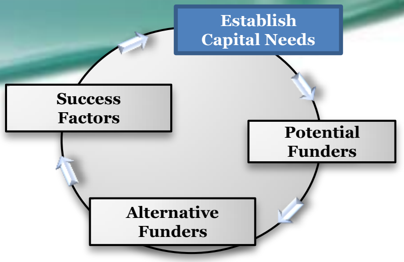
Establish Capital Needs (Cont'd.):
Financial feasibility

- Total start-up cash needed
  - Prepare an actual budget that lists all anticipated capital purchases and operating expenses needed to generate the first $1 in revenues
- Forecast future sales, expenses, income, and capital expenditures:
  - Provides basis for your pro forma balance sheet, income statement, cash flows
  - Helps create accurate budgets, build financial plans, and manage finances in a proactive (rather than a reactive) manner
    - *… but projections are not promises!*
- Assess whether you have enough resources to launch the proposed venture
  - Determine if the business plan is realistic given the total cash needed



Establish Capital Needs (Cont'd.):
Don't forget non-cash!

- List 5-10 most critical non-financial resources that will be needed to move the business idea forward successfully:
  - Affordable space
  - Local and state government support
  - Quality of the labor pool and their willingness to join
  - Proximity to key suppliers and/or customers
  - Likelihood of establishing favorable strategic partnerships, including with those who can share knowledge
  - Intellectual property protection



Establish Capital Needs (Cont’d.):
Average invested by start-ups

Where it comes from:

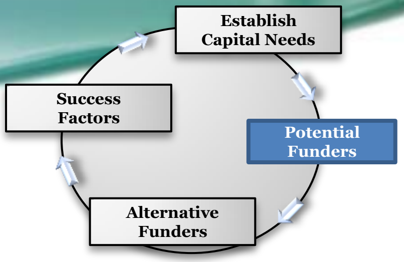
Source	Average Amount	Example
Owner equity:	$27,365	Personal savings
Insider equity:	$1,695	Spouse and parents
Outsider equity:	$6,979	Informal investors, business, government, venture capitalists
Owner debt:	$3,506	Personal owner debt
Insider debt:	$7,605	Family loans
Outsider debt:	$31,255	Personal bank loans, credit card balances, credit lines
Total startup funding from all sources:	$531 billion	

Equity ≈ $36K

Debt ≈ $42K

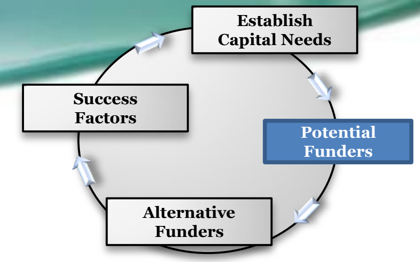
Total ≈ $78K

http://www.forbes.com/sites/work-in-progress/2012/09/21/the-jobs-act-what-startups-and-small-businesses-need-to-know-infographic/



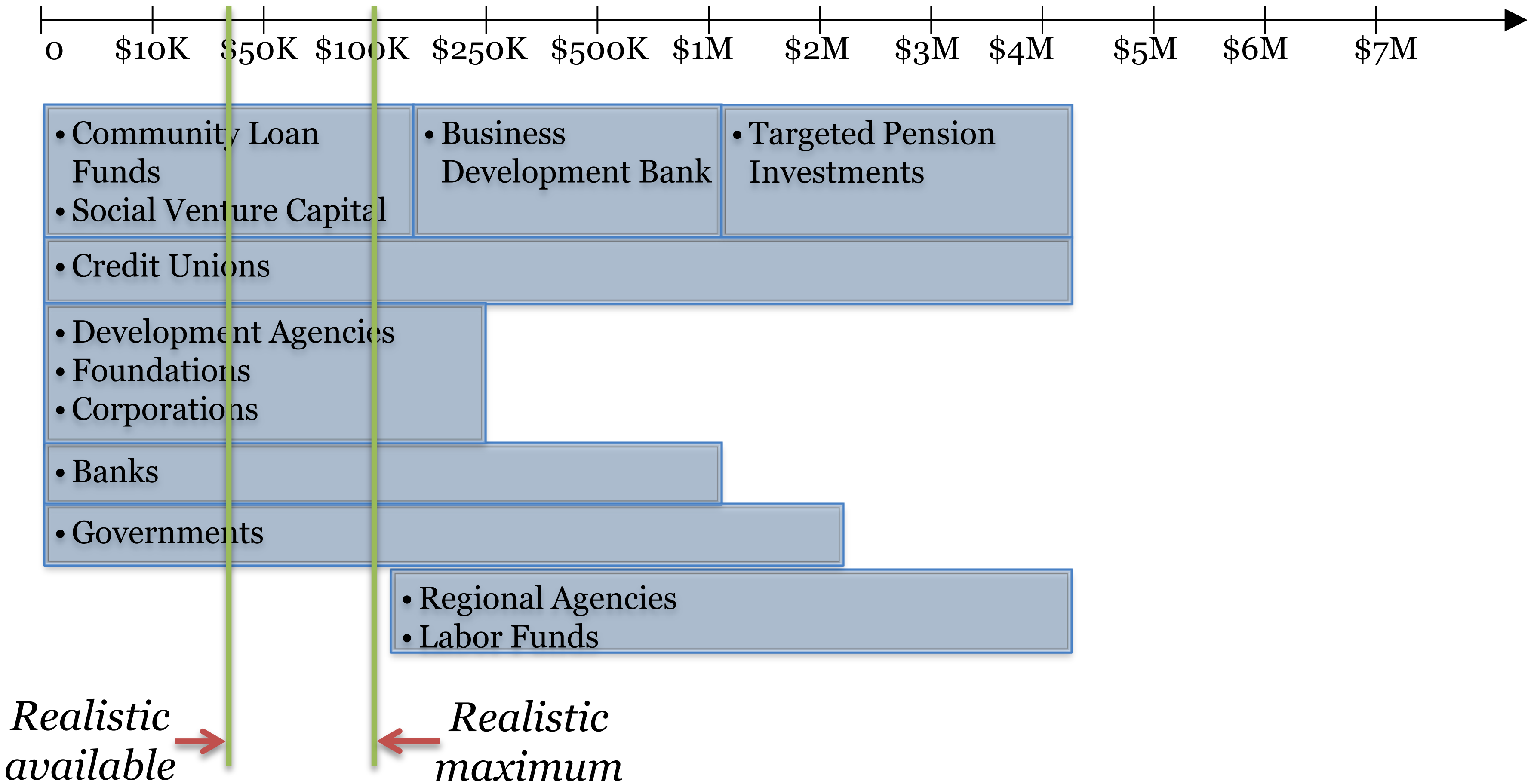
Potential Funders:
Identify candidates

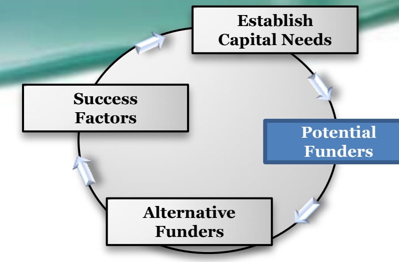
- Current supporters and their networks:
  - Existing member
  - Donor database
  - Staff/volunteer knowledge
- Networking
- Interviews
- Research:
  - Competition
  - Rich lists
  - Trusts
  - Media
  - Funder groups
  - Companies
  - Demographics



Potential Funders Cont'd.):

Identify candidates (cont'd.)



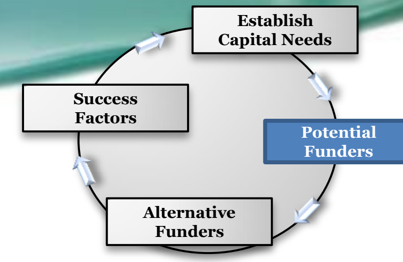


Potential Funders (Cont'd.): *Examples*

Grants	Fellowships	Loan Providers
•DoSomething.org •Google Grants •Kauffman Foundation •Social Innovation Fund	•Acumen Fund •Ashoka •Echoing Green •Skoll Foundation •Unreasonable Institute	•Calvert Foundation •Partners for the Common Good •ShoreBank •UAlbany SEED http://www.albany.edu/seed/

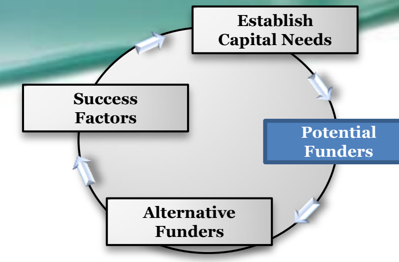
Angels/ Venture Capitalists	Crowdfunding/ On-Line Platforms
•Blue Ridge Foundation •Calvert Group •Good Capital •Grey Ghost Ventures •Investors Circle •Mission Markets	•CauseVox •Change.org •Kickstarter •Kiva •Pepsi Refresh Project ($50k to http://www.selflesstee.com/)

Source: Figure 6.1 in Kickul & Lyons, *Understanding Social Entrepreneurship* (2012)



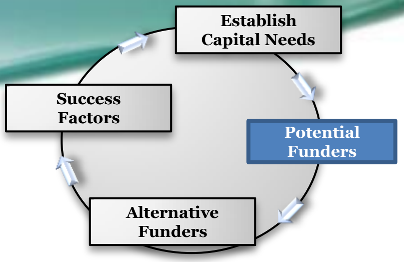
Potential Funders (Cont'd.)

Characteristic of the Venture	Appropriate Source of Funding
High risk/uncertain return: • Weak cash flow • High leverage • Low-to-moderate growth • Unproven management	3 Fs (founders, friends, family) Bootstrapping
Low risk/predictable return: • Strong cash flow • Low leverage • Audited financials • Good management • Healthy balance sheet	Debt financing
High return: • Unique business idea • High growth • Niche market • Proven management	Equity

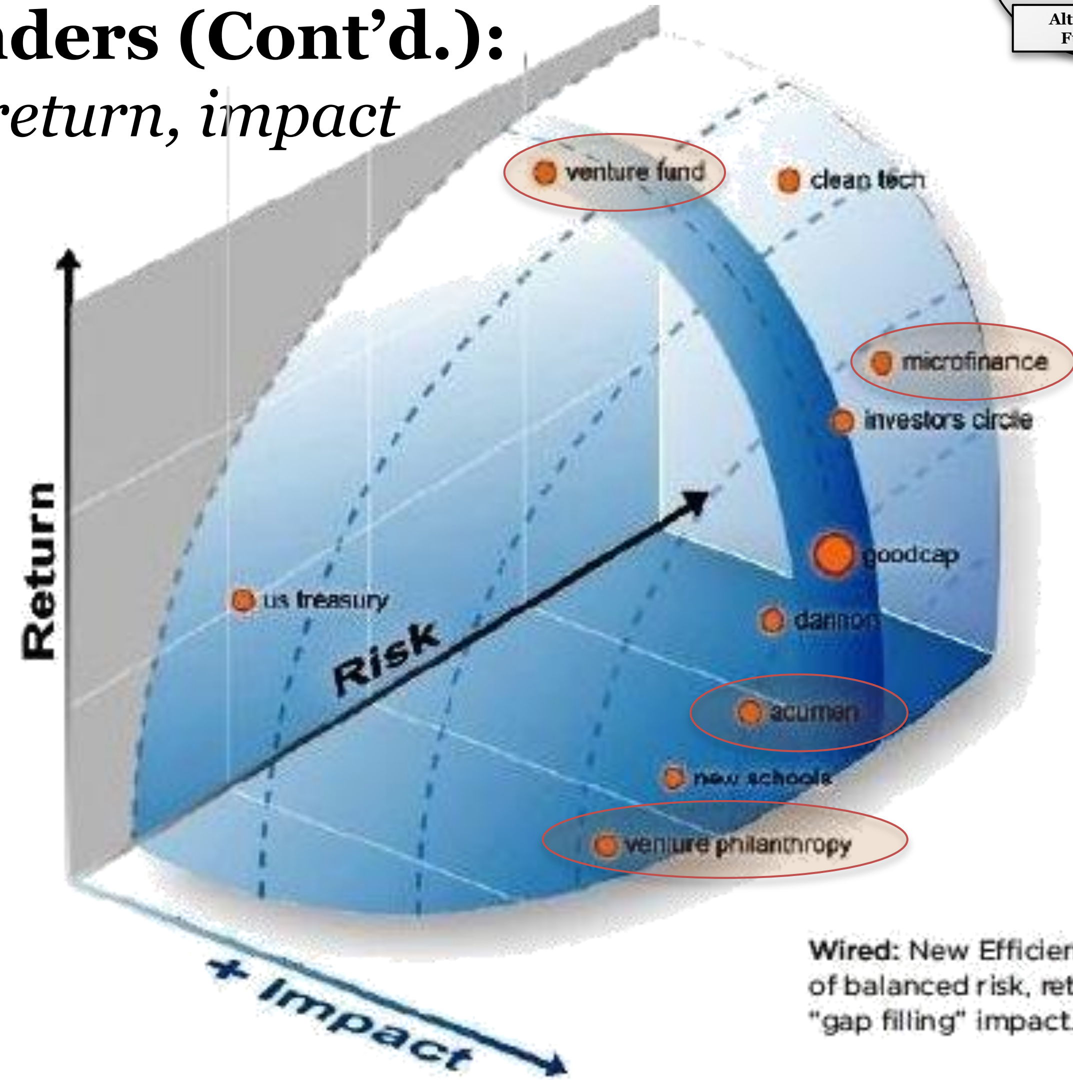


Potential Funders (Cont'd.):
Assessing risk

		Depth of the Management Team			
		Social entrepreneur working alone	Several partners, no team	Management team identified	Management team in place and working
Development Stage of the Venture	*Venture in the planning stage, not yet operable*	Greater risk	→ Solo entrepreneurs carry more risk		Less risk
	Venture in pilot stage	↓ Younger ventures carry more risk			
	Venture launched but not developed				
	Venture operating at working capacity	Less risk			

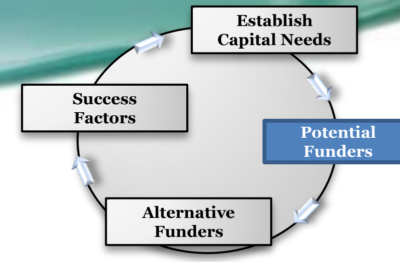


Potential Funders (Cont'd.):
Assessing risk, return, impact



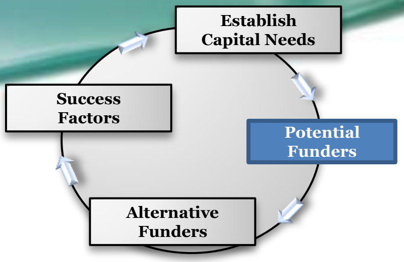
Wired: New Efficient Frontier — area of balanced risk, return, with maximum "gap filling" impact.

Source: http://www.impactassets.org/files/downloads/ImpactAssets_IssueBriefs_2.pdf



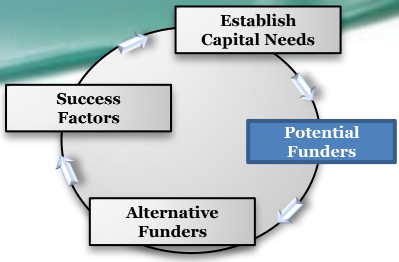
Potential Funders (Cont'd.):
Founders and personal financing

- The vast majority of founders contribute personal funds (along with "sweat equity") to their ventures
- Outside investors and lenders expect entrepreneurs to put some of their own capital into the business before investing theirs
- Some ventures get started with "bootstrapping" – Finding ways to avoid the need for external funding through creativity, ingenuity, thriftiness, cost-cutting, or any means necessary



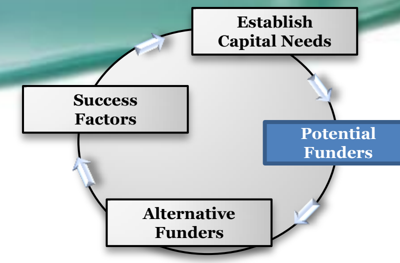
Potential Funders (Cont’d.):
Bootstrapping examples

- Buying used instead of new equipment
- Coordinate purchases with other businesses
- Leasing equipment instead of buying
- Obtaining payments in advance from customers
- Minimizing personal expenses
- Avoiding unnecessary Expenses
- Buying items cheaply but prudently via options such as eBay
- Sharing office space or employees with other businesses
- Hiring interns



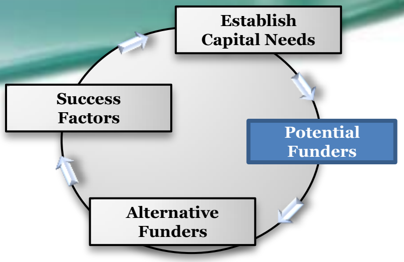
Potential Funders (Cont'd.):
Friends and family members

- Most likely to invest in the business
  - Inherent dangers lurk in these business deals, especially those that flop
- Guidelines:
  - Consider the impact of the investment on everyone involved
  - Keep the arrangement "strictly business"
  - Prepare a business plan
  - Settle the details up front
  - Never accept more than investors can afford to lose
  - Create a written contract
  - Treat the money as "bridge financing"
  - Develop a payment schedule that suits both parties
  - Have an exit plan



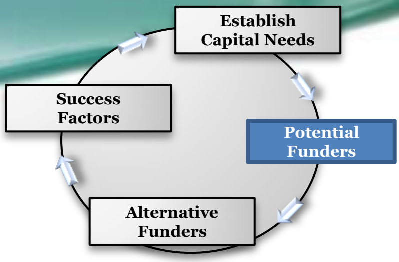
Potential Funders (Cont’d.):
Debt

- Must be repaid with interest
- Carried as a liability on the balance sheet
- Can be just as difficult to secure as equity financing, although more numerous sources
- Can be expensive (especially for small companies) because of risk/return tradeoff
- Asset-based lenders pledge collateral (accounts receivable, inventory, etc.)
- *Other sources:* Vendor, equipment suppliers, commercial finance companies, saving and loan associations, stock brokers, credit unions, private placements, Small Business Investment Companies (SBIC), Small Business Lending Companies (SBLCs)



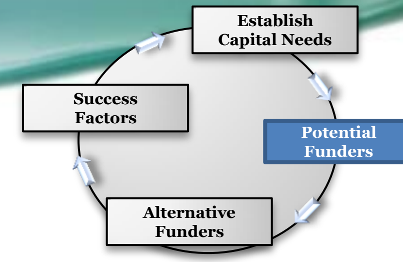
Potential Funders (Cont’d.):
Debt (cont’d.)

- Commercial Banks:
  - Historically, commercial banks were not a practical source of financing for start-up firms
    - Were risk adverse, and financing start-ups is a risky business
    - Interested in firms with a strong cash flow, low leverage, audited financials, good management, and a healthy balance sheet
  - Today, are lenders of first resort for small businesses
    - 12% of entrepreneurs receive bank loans to start their businesses
    - Average microloan = $7,400
    - Average small business loan = $181,000



Potential Funders (Cont'd.):
SBA guaranteed loan program

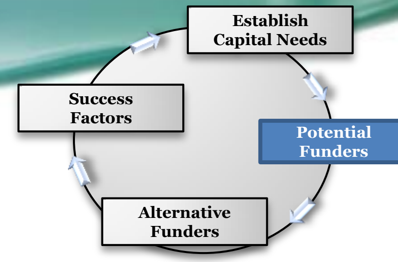
- Approximately half of the 9,000 banks in the U.S. participate
- Operates through private-sector lenders that provide loans guaranteed by the Small Business Administration
- Loans are for small businesses that are not able to obtain credit elsewhere
- The 7(A) Loan Guaranty Program is the most notable SBA program available to small businesses:
  - Lender and SBA share risk that loan will not be repaid in full
  - New York Business Development Corporation works with lending partners to provide loans to small businesses in New York State, including under 7(A)



Potential Funders (Cont'd.):
UAlbany SEED program

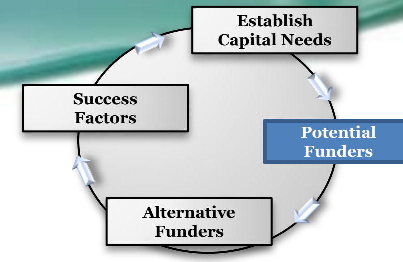
- Provides assistance in accessing capital to start or expand a small business:
  - $35,000 microloan
  - Help develop business model
    - Small Business Development Center
    - Interns from the UAlbany School of Business and School of Social Welfare
  - Entrepreneurial training classes
  - One-on-one business counseling and research assistance
  - Peer mentoring support

SEED
Small Enterprise Economic Development
UNIVERSITY AT ALBANY SMALL BUSINESS DEVELOPMENT CENTER



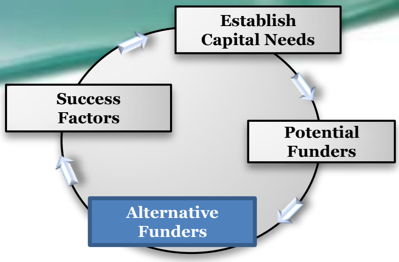
Potential Funders (Cont'd.):
Venture capital

- Money managers who raise investment funds from wealthy individuals, pension plans, university endowments, foreign investors, etc.:
  - More than 740 venture capital firms operate across the U.S.
  - Most venture capitalists seek investments in the $3 million to $10 million range
  - On average, 98% of venture capital goes to early stage investments or expansion stage investments … Only 2% goes to businesses in the startup or seed phase
  - About 300 large corporations across the globe invest in start-up companies, approximately 6-8% of all venture capital invested
- *Due Diligence* – Business plans subjected to an extremely rigorous review (less than 1% accepted)
- Target companies with high-growth and high-profit potential and so reject the majority of the proposals they consider:
  - Many entrepreneurs get discouraged when they are repeatedly rejected for venture capital funding, even though they may have excellent business plan
  - For firms that qualify, venture capital is a viable alternative to equity funding
- Capital infusions are just one benefit; may share marketing and technical expertise



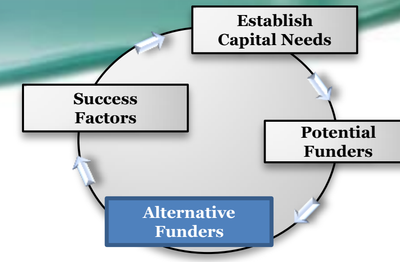
Potential Funders (Cont'd.):
Equity

- Reasons for firms to go public:
  - Fund current and future operations
  - Raise public profile, making it easier to attract high-quality customers and business partners
  - A liquidity event that provides a means for a company's investors to recoup their investments
  - Creates a form of currency that can be used to grow the company via acquisitions
- Initial public offering – First sale of stock to the public
  - Most companies have over $25 million in annual sales
- Traded on stock exchange
  - Most entrepreneurial firms that go public trade on the NASDAQ, weighted heavily toward technology, biotech, and small-company stocks
- Typically, the firm has demonstrated that it is viable and has a bright future



Alternative Funders:
Business angels

- Wealthy individuals who invest their personal capital directly in start-ups in exchange for equity (ownership) stakes
  - About 258,000 angels across the U.S. invest $26 billion a year in 57,000 small companies
  - 265 angel groups across the U.S.
- Excellent source of "patient" money:
  - Invest between $10,000-$500,000 in a single company … but could be as much as $5 million
  - Want companies with potential to grow 30%-40%/year
  - Over half lose money, but 7% produce a return more than 10 times their original investment
- Difficult to find!
  - Look nearby, 7 out of 10 angels invest in companies that are within 50 miles of their homes or offices
  - Informal angel "clusters" and networks
  - See https://angel.co/

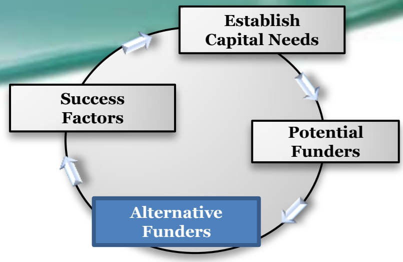


Alternative Funders (Cont'd.):

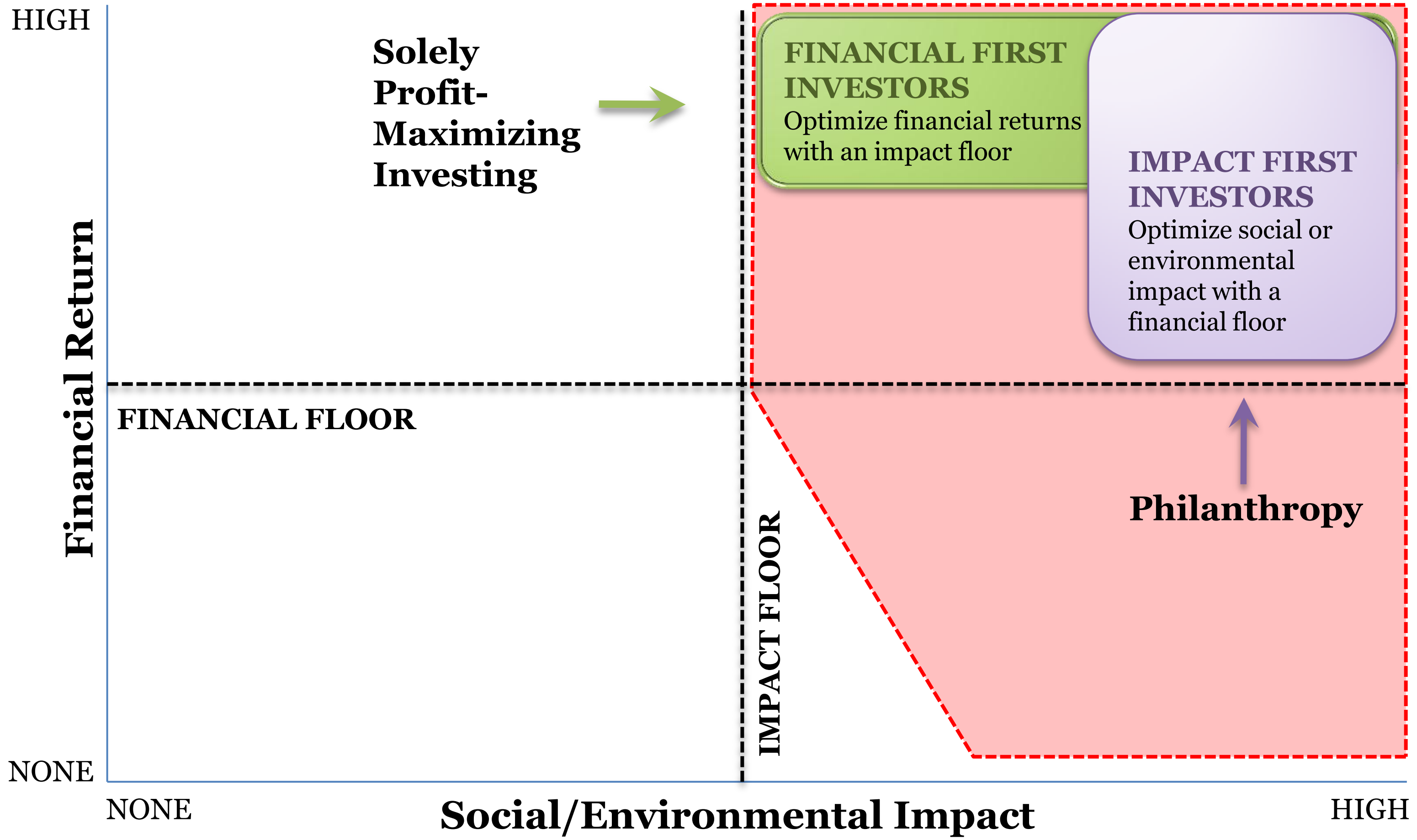
Venture philanthropy

- Reliable, long-term grant money
- Early-stage capital and human investments (expertise, coaching) in businesses expected to grow and produce significant social returns
- High engagement over many years with fixed milestones and tangible returns, with exit achieved by developing alternative, sustainable income

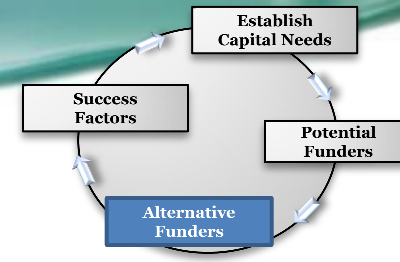
- Priority:
  - Fit values/vision
  - Significant problem
  - Appropriate solution
    - Entrepreneur's characteristics
    - Venture's characteristics
    - Impact/build on success
    - Innovative and entrepreneurial
  - Potential to improve organization
    - Evaluation systems
    - Jointly develop strategic plan
    - Fundraising ability



Alternative Funders:
Impact investors ("blended value")



Source: Figure 6.3 in Kickul & Lyons, *Understanding Social Entrepreneurship* (2012)



Alternative Funders (Cont'd.): *Crowdfunding*

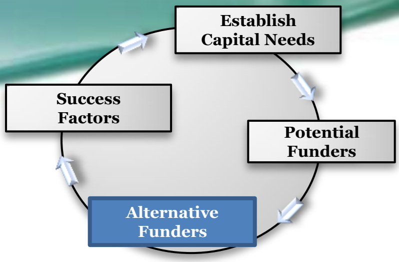
CROWDFUNDING TODAY

Company	Industries served	Funding	Types of raises
FUNDABLE	Startup businesses.	\$5,000-\$25,000 typical amounts raised.	Reward and equity-based raises.
KICKSTARTER	Films, music, journalism, gaming.	\$241 million to date.	Rewards only; has publicly expressed that it will not offer equity
RocketHub	Theater, film, fashion, business.	10,000 campaigns funded.	Currently rewards; looking to offer equity
indiegogo	Music, charity, small business, film.	100,000+ campaigns funded.	Currently rewards; may try to offer equity

Examples of Rewards:

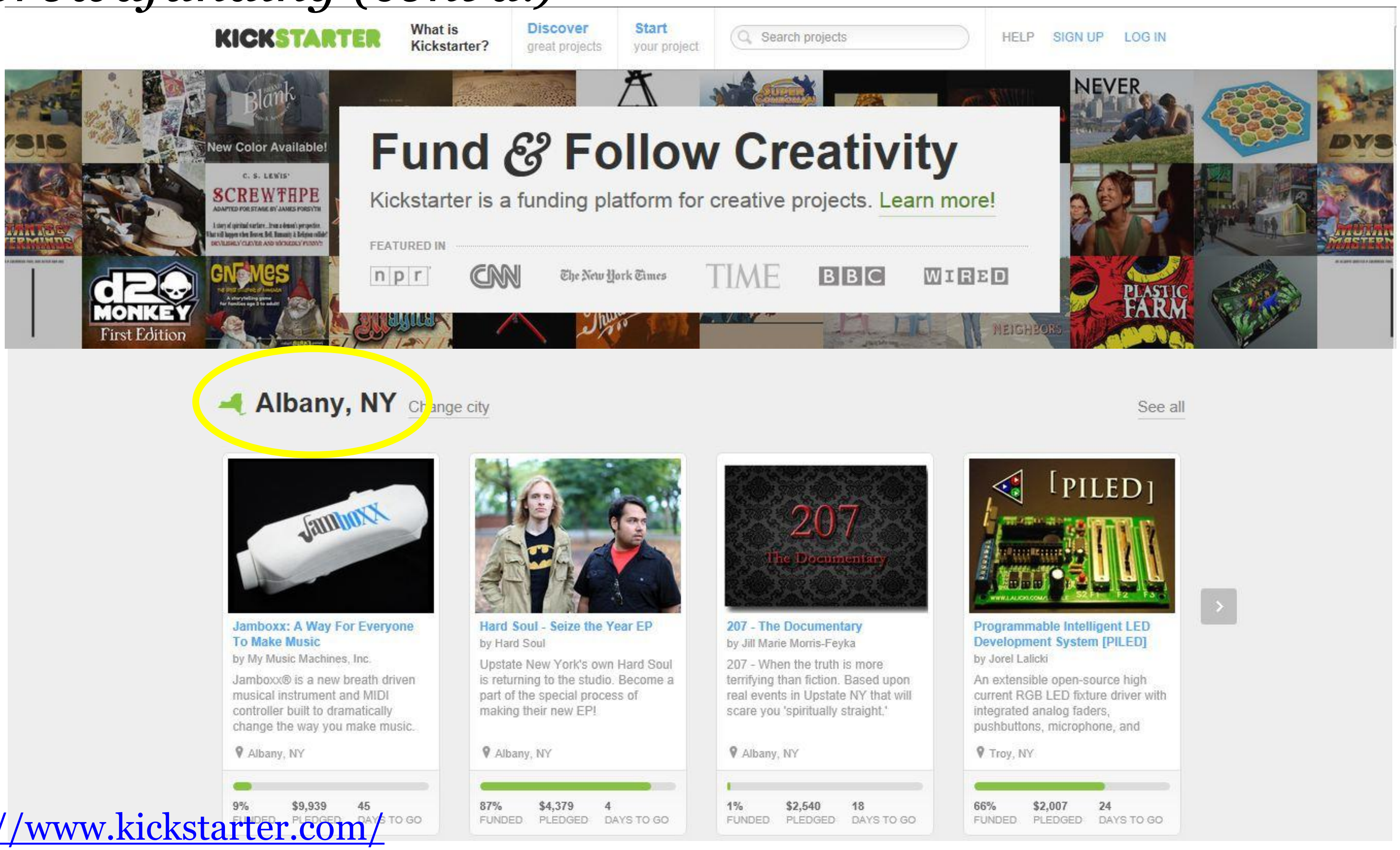
- **Gestures** – Photographs, a "thank you" or special mention on a site, a walk-on role, a product named after them
- **The Obvious** – Your end product such as albums, games, graphic novels, gadgets, artwork, DVDs, etc.
- **Events** – Thank your "big ticket" supporters with a picnic or dinner parties in a few key cities; make some phone calls; invites to a premiere or cast party
- **SWAG** – "Stuff We All Get" include one-of-a-kind/limited editions such as custom and/or autographed T-shirts, books or posters, coffee mugs, mousepads, and other inexpensive gifts that relate to your project

http://www.forbes.com/sites/work-in-progress/2012/09/21/the-jobs-act-what-startups-and-small-businesses-need-to-know-infographic/

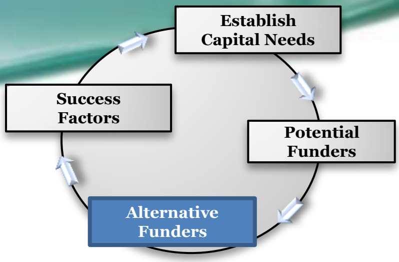


Alternative Funders (Cont'd.):

Crowdfunding (cont'd.)

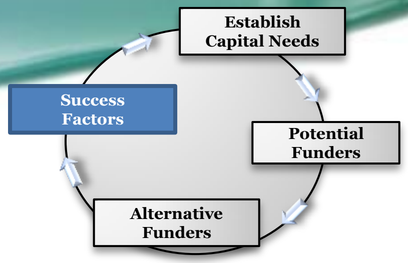


http://www.kickstarter.com/



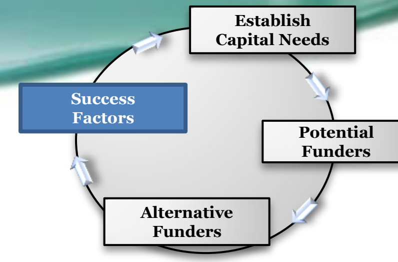
Alternative Funders (Cont'd.):
Specialized sources

- **Count Me In** at http://www.countmein.org/ provides loans of $500 to $10,000 to women starting or growing a business
- **Donors Choose** at http://www.donorschoose.org/ specializes in grants for specific school projects that are too small for most funders to continue
- **Investors' Circle** at http://www.investorscircle.net/ is a network of angel investors and VCs that invests "patient" capital in companies that address social and environmental issues
- **Shared Interest** at http://www.shared-interest.com/ invests in fair trade businesses
- **Underdog Ventures** at http://www2.underdogventures.com/ focuses on natural and organic food, environment and conservation, socially responsible consumer products, and socially responsible investment companies



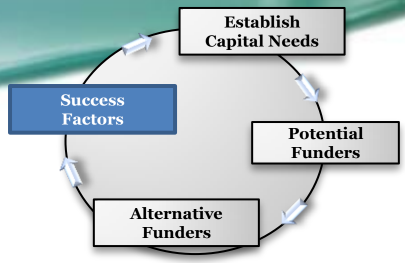
Success Factors:
Understanding funder motivation is key!

- Funders have different priorities and intentions:
  - Some want financial return on investment and not social benefits
  - The "socially focused" support causes that are important to them
  - There are those who attach importance to the quality of the organization's business model and track record
  - The "hassle free" do not want to get overly involved
  - Those who personally belong to the entrepreneur's social network
  - Skeptics who are not interested in blending social and financial value creation, preferring instead to keep their charitable giving and financial investments separate



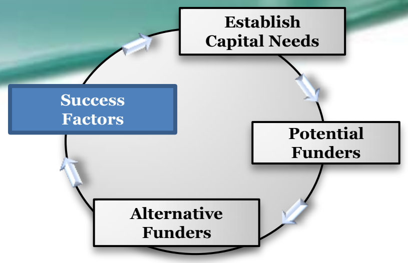
Success Factors (Cont'd.):
Due diligence questions

- What is the impact investment thesis for this opportunity and how does it further specific impact goals?
- Is this a financial first or impact first investment? How are the social impact and financial risks distributed?
- Who are the principals involved in the investment?
- Does the transaction leverage other sources of capital?
- Will this investment enable a project to happen that otherwise would not?
- Does the investment raise reputation or policy issues?
- Where does this transaction fit in asset allocation?



Success Factors (Cont’d.):
Strategic partners

- Many partnerships are formed to share the costs of developing the product or service, to gain access to particular resources, or to facilitate speed to market
- Older established firms benefit when partnering with young entrepreneurial firms by gaining access to their creative ideas and entrepreneurial spirit
- Socially responsible corporations and good corporate citizens can be good partners for a social enterprise if their missions are aligned
    - Corporations support social entrepreneurs through grants from their corporate foundations or through their operating divisions, which may see a social enterprise as an opportunity to innovate or reach a new market



Success Factors:
Obtaining the investment

- For your next presentation ("dry run"):
  - Is the proposal convincing?
  - Did the unique value come through?
  - Is the proposal customer-driven?
  - Was it credible? Was it enthusiastic?
  - Would you remember the presentation? Was the style compelling?
  - Did it catch your attention in the first minute?
  - Was the "ask" or proposal clear?
- Be patient/persistent, in the "real world" it could take up to 2 years!

Conclusions

- All new ventures require cash, collateral, credit, or connections – but also consider bootstrapping and strategic partners to minimize needed funds
- There are many types of potential donors and investors, each with its own characteristics and requirements – but also consider such unconventional funders as impact investors, social media, specialized sources
- Raising money takes time and effort – Develop a strategy to raise funds based on the needs, motivation, and mission of the various sources
- Be thoroughly prepared for due diligence before approaching lenders and investors, and build on your current network
- The Internet puts vast resources of information at entrepreneur's fingertips that can lead to financing – use it!
- For more information and sources, see http://www.pinterest.com/mgt460/microfinance/ and http://www.pinterest.com/mgt460/crowd-sourcing-other-funding-opportunities/

Course Purpose

- Summarize key principles of social entrepreneurship
- Identify the challenges and opportunities of social entrepreneurship
- Use evidence to analyze, evaluate, and exploit a social opportunity for an entrepreneurial venture
- Apply business functions to create and sustain a social venture
- Prepare a business plan for a social enterprise

Questions?