Chapter 5
Social Enterprises and the Financing of Different Scaling Strategies

Wolfgang Spiess-Knafl and Stephan A. Jansen

Abstract This article discusses the financing options and scaling models of social enterprises. Social enterprises use various revenue streams to cover their operational expenses and financing instruments for longer-term investments. Revenue streams include fixed fees, earned income or membership fees while financing instruments are grants, debt capital, equity capital, mezzanine capital or hybrid capital.

Based on the degree of control of the business model and the speed of scaling four different scaling models can be identified. Social enterprises can either be networkers, blueprinters, localizers or scalers. The article discusses the elements of each scaling model and analyzes the financing strategies as well as their implications.

Keywords Public funding · Scaling · Internal financing

5.1 Introduction

Social entrepreneurship is a promising concept for the solution of pressing social issues by applying business techniques and an entrepreneurial mind-set to social problems (Dees 1998; Mair and Marti 2006). The visible success of social enterprises supported and promoted by fellowship associations such as the Schwab Foundation for Social Entrepreneurship or Ashoka has also attracted interest from public authorities and foundations. Their financial commitment to support social enterprises has helped to develop a "social capital market" with a range of financial institutions covering different risk-return segments (Achleitner et al. 2011).

There is a common understanding that social enterprises provide public goods or create social value (e.g. Sommerrock 2010; Zahra et al. 2009). However, as empirical studies and most practical evidence show, social enterprises are mostly active at a local level with rather limited resources (Light 2008; Spiess-Knafl 2012). In light

W. Spiess-Knafl (✉) · S. A. Jansen
Zeppelin University, Friedrichshafen, Germany
e-mail: Wolfgang.Spiess-Knafl@zu.de

S. A. Jansen
e-mail: stephan.jansen@zu.de

L. Pate, C. Wankel (eds.), *Emerging Research Directions in Social Entrepreneurship*, Advances in Business Ethics Research 5, DOI 10.1007/978-94-007-7896-2_5,
© Springer Science+Business Media Dordrecht 2014

of their own social mission and in order to retain their legitimacy social enterprises need to scale up their concept to provide their services to a greater number of people.

This chapter will present the financing of social enterprises, discuss different scaling strategies and highlight the implications and difficulties of these approaches. Some interesting research questions which may be of interest for future research in this field will also be discussed. For example, it remains unclear what the best diversification strategy would be in terms of income sources for social enterprises. There are arguments pushing for more diversification since that promises greater stability and less volatility, while on the other hand a higher level of diversification also means that there is a greater risk for potential conflicts of interests between the different capital providers.

The implications of public funding also need consideration. Some researchers and practitioners think that social enterprises should act independently of public funding as it seems to contradict an entrepreneurial approach. However, public authorities are keen to support this phenomenon of social entrepreneurship which, according to definition, should not pursue this kind of funding. All of this leads to quite a paradoxical situation.

5.2 The Financing of Social Enterprises

Social enterprises need to develop a financing strategy to cover their on-going operational expenses and to finance their scaling efforts to increase the dimension of their activities. On-going operational expenses are usually covered by internal financing (revenue streams) whereas scaling expenses are usually covered by external financing (financing instruments) provided by institutions in the social capital market (Achleitner et al. 2011).

External financing is provided in the form of equity capital, debt capital, mezzanine capital, hybrid capital or donations and is commonly used to cover long-term investments or temporary negative operating cash flows. These funds can be provided by investors which can be differentiated along their financial return requirements. Internal financing consists of revenue streams received by the social enterprise in return for the provision of its services and products. Depending on the financial capabilities of the target group this revenue stream is either paid by the target group itself or third parties such as companies willing to pay for qualification services or public authorities. These financing sources with the financing instruments and revenue streams are shown in the following figure (Fig. 5.1).

5.3 Capital Structure

5.3.1 Financing Sources

There are basically three groups of investors which provide capital for social enterprises: (1) investors without financial return expectations, (2) investors with

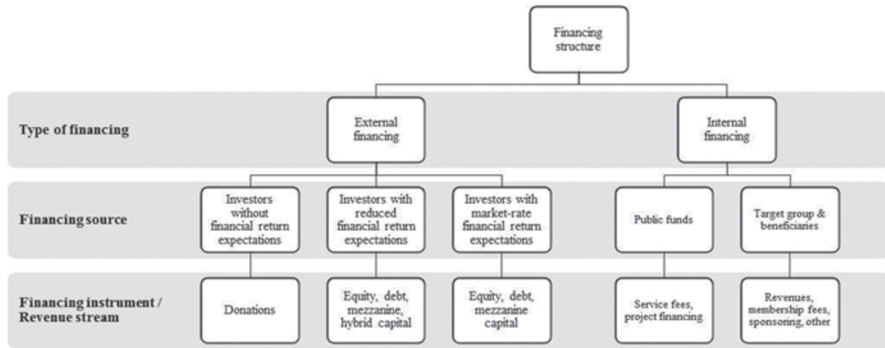

Fig. 5.1 Financing structure. (Achleitner et al. in press)

reduced financial return expectations and (3) investors with market-rate financial return expectations.

Investors without financial return expectations are donors or foundations which provide funding with the sole focus of supporting the provision of a social good. Given that self-interest is a major component in economic theory it is not obvious why individual giving reaches significant amounts each year (see e.g. Havens et al. 2006; Sommerfeld 2009). Andreoni (2001) offers three possible explanations for philanthropic behavior. A donation can help to produce a public good which the donor values. This is consistent with the observation that non-profit organizations often report the output which can be provided with a certain sum (Vesterlund 2006).

A private benefit can accrue in the form of free entrance or privileged access to exhibitions. Donations can also enhance the reputational status of the donor. A place in the supervisory board of an organization or the naming of a building can be examples for this form of private benefit. The third aspect according to Andreoni (1990) is the warm glow effect. That means that the act of giving alone is of a certain value to the donor (e.g. Crumpler and Grossman 2008; Harbaugh 1998 and for an alternative view see for example Belk and Coon 1993).

Investors belonging to the second group reduce their financial return expectations in order to support the provision of certain social services. This balancing of social and financial return is also known as "Blended Value Proposition" (Emerson 2003).

There is a belief among so called philanthrocapitalists that the use of financial instruments supports the entrepreneurial orientation of a social enterprise (Bishop and Green 2008). The origins of this investment approach go back to the 1990s when entrepreneurs who had gained fortunes over a short time span with investment management or information technologies were experimenting with new investing approaches (Letts et al. 1997). One of those investing approaches evolved into venture philanthropy funds which use venture capital techniques to support social enterprises (Heister 2010; Moody 2008). The perceived success of these funds has also helped to create a social capital market.

Thirdly, investors with market-rate financial return expectations provide capital to social enterprises that they consider will achieve a return which is comparable to an investment in the traditional for-profit sector. O'Donohue et al. (2010) call these impact investments in contrast to social investments which have a reduced financial return. Typical impact investments are made in community development programs in industrial countries or bottom of the pyramid approaches in emerging countries such as energy solutions, microfinance or health care services.

5.3.2 Financing Instruments

Social enterprises have access to all of the financing instruments of the for-profit sector such as equity, debt and mezzanine capital as well as those of the non-profit sector including debt capital and donations (Achleitner and Spiess-Knafl 2012).

Donations are usually provided by foundations and individuals and seem to be rather attractive for social enterprises. The donor does not receive any control or voting rights and the donations is not repayable. However, they are usually restricted for predefined projects, entail high fundraising costs and lower entrepreneurial flexibility. We classify donations as a financing instrument which is in contrast to the non-profit research area where researchers typically view donations as a revenue source (e.g. Besel et al. 2011; Fischer et al. 2011). However, this classification as a financing instrument is in line with accounting standards and the economic reality of social enterprises. Social enterprises usually do not build their business model on a donation model but often receive large sums in form of donations from venture philanthropy funds or foundations (for an overview of fundraising strategies see de Oliveira et al. (2011) or Meer and Rosen (2011)).

Debt capital can be used to finance long-term investments as well as working capital requirements. As the social enterprise needs to make regular interest payments and repay the complete amount at the end of the period, it needs to have predictable cash flows and a low-risk business model. This requirement to keep a low-risk business model seems to dampen the innovativeness and risk-appetite of social enterprises (Milligan and Schöning 2011). Debt capital gives the social enterprise high entrepreneurial flexibility in the use of the funds but also entails the loss of far-reaching rights in case of default.

Equity capital is also used to finance long-term investments and working capital-requirement as well as to cover short-term negative operating cash flows. Equity capital does not entail repayment but gives the capital provider control and voting rights as well as a share of the profits. There are different views on the distribution of profits by social enterprises. Yunus (2006) prefers a restriction of any dividends, while others see a limited profit distribution as worth pursuing as it also reflects the primacy of a social aim (e.g. Defourny and Nyssens 2008).

A shareholder structure with external investors could potentially have an impact on the corporate culture of the social enterprise. As of this point, the investor can hardly exit the investment as there is no secondary equity capital market. Social

stock exchanges which could be an interesting exit options for social investors have been established but have not gained enough size to have a functioning market (Achleitner et al. 2011).

Mezzanine capital is a combination of equity and debt capital with fixed interest rates and a repayment obligation as well as an additional performance-related component. It can be structured flexibly and gives the investor profit participation rights in case of financial success. Similar to debt capital it requires predictable cash flows and a low-risk business model.

There are also a number of tailored financing instruments for social enterprises in the form of hybrid capital which combine elements of equity or debt capital with donations. They are usually an inexpensive financing instrument with a great degree of structuring flexibility and no dilution of ownership. Examples of such financing instruments include recoverable grants, convertible grants, forgivable loans or revenue-share agreements. The repayment of a recoverable grant depends on the development of the social enterprise as it is only repayable in case of success, whereas a forgivable loan is forgiven if certain pre-agreed milestones are reached. The choice depends on the motives of the capital providers. Convertible grants are converted into equity if the company proves to be successful. Revenue share agreements are financing instruments which give the capital providers a certain share of the revenues of a social enterprise (Achleitner et al. 2011; Table 5.1).

There are two major differences between financing in the for-profit and the social-enterprise sectors. In the for-profit sector there is a clear correlation between the interest-rate of a loan and the default risk of the enterprise. For social enterprises this relationship does not apply as investors might be willing to reduce their financial return requirements for the social mission. Low-interest loans or zero-interest loans are therefore rather unrelated to the risk of the social enterprise. The same is true for the pecking order framework in which enterprises in general are supposed to prefer internal financing to debt and equity capital (Harris and Raviv 1991). For a number of reasons this framework does not apply to social enterprises. Although grants are hard to beat in financial terms as they have no repayment requirements, social enterprises could still prefer equity or debt capital due to the increased flexibility of these instruments. Moreover, potential investors have limited opportunities to profit from the entrepreneurial success as profit distribution is either prohibited or limited (cf. CIC Regulator 2013; Hoogendorn et al. 2010; Kerlin 2006).

The question also remains as to which financing instrument is most appropriate for which life cycle of the social enterprise. In a study of 110 venture philanthropy fund investments on a global basis it was found that only 55.5 % of the investments were based on equity capital. 40.0 % of the investments were based on a loan agreement or were a combination of debt and equity capital. The remaining 4.5 % of all investments were based on hybrid capital such as guarantees or revenue-share agreements (Spiess-Knafl 2012).

Table 5.1 Financing instruments for social enterprises. (Achleitner et al. 2011)

Financing instrument	Term sheet	Implications for social enterprise
Grants	Duration: Short term Annual payments: None Repayment: None	Usually restricted use for predefined projects High fundraising costs Low entrepreneurial flexibility
Debt Capital	Duration: Long term Annual payments: Interest payments Repayment: Yes	Low risk business model required No dilution of ownership Loss of far-reaching rights in case of default High entrepreneurial flexibility
Equity Capital	Duration: Unlimited Annual payments: Dividend payments Repayment: No	Dilution of ownership Control and voting rights for investors Profit participation for social investor Potential impact on corporate culture
Mezzanine Capital	Duration: Long term Annual payments: Interest payments Repayment: Yes	Structure require predictable cash flows Dilution of ownership if converted into equity Mandatory repayment Profit participation for social investor
Hybrid Capital	Duration: Longterm Annual payments: None Repayment: Depends upon structure	Inexpensive financing instrument No dilution of ownership Risk sharing with the social investor Great structuring flexibility

5.4 Internal Financing

The internal financing structure consists of revenue streams. Revenue streams can be divided into those provided by public authorities and those provided by private sources. The classification involving the different revenues streams is shown in the figure below (Fig. 5.2).

5.4.1 Public Funding

Public funding is a major component of the income structure of social organizations (e.g. Adema and Ladaique 2009; Salamon and Anheier 1997). Public funding can either be provided through fixed fees based on contracts or subsidies (Rushton and Brooks 2007).

Fixed fees are paid for the provision of services irrespective of the existing local demand on behalf of government. It is either paid per person (e.g. elderly care, overnight accommodation for homeless) or by delivering the service for a certain area

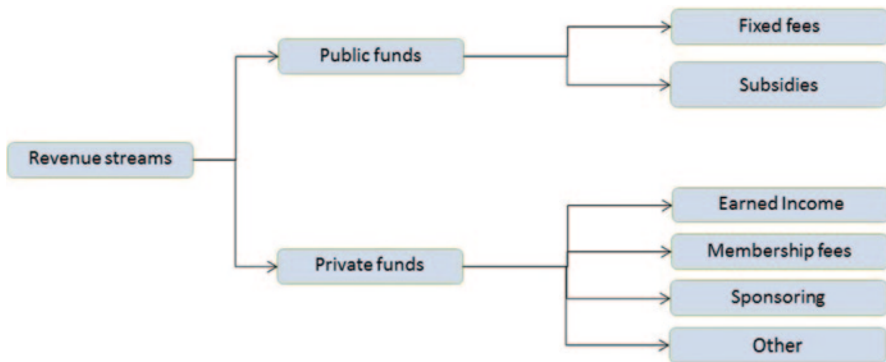

Fig. 5.2 Revenue streams. (Spiess-Knafl 2012)

such as rescue services or primary education (Achleitner et al. in press). It is thus possible to speak of quasi-markets in which social enterprises are active. Studies show that quasi-markets represent significant revenue sources for social enterprises (Social Enterprise UK 2011; Spiess-Knafl 2012).

Subsidies are mostly provided for certain projects which the public authorities want to promote and support. These subsidies often require significant reporting efforts and come with strings attached (Rushton and Brooks 2007). Fees and subsidies often work in a way that refunds only according to incurred expenses limiting the incentive to work efficiently (Bank of England 2003).

These aspects explain why social enterprises attempting to access public funds are sometimes considered not entrepreneurial enough (see Defourny and Nyssens (2010) for a discussion). Although there may be good reasons for this view it generates a paradoxical situation as public authorities are changing their funding mechanisms to give social enterprises access to this capital pool. Governments are supporting social enterprises by modifying their funding schemes for the requirements of social enterprises and setting up new initiatives such as social impact bonds or social innovation funds (Cohen 2011; Mendell and Nogales 2009). Additionally, empirical findings show that public funds are a highly scalable and stable income stream comparable only to income generated by the target group (Spiess-Knafl 2012).

5.4.2 Private Funding

Private funding can consist of earned income, membership fees, sponsoring and other income streams such as irregular prize money or regular income from an endowment.

Earned income is generated through services provided or products sold to the target group. Earned income has the benefit that there are no restrictions in the use

of those funds. Within the non-profit literature this revenue stream is often seen as subsidizing the core non-profit segment by generating income in often unrelated business schemes (see e.g. James 1986; Sinitsyn and Weisbrod 2008; Weisbrod 1998). There is a consensus in the "Social Enterprise School of Thought" that the earned income generation of social enterprises should be related to the problem the social enterprise wants to solve (Hoogendorn et al. 2010).

The need for revenue generation also implies that there must be some kind of pricing and/or allocation mechanism when it is realistically impossible to provide every potential client with the services or products. Social enterprises can use a range of different allocation mechanisms which are either price-based or non-price-based. Pricing may differ between different groups of customers or there may be eligibility criteria for the services (Steinberg and Weisbrod 1998). The aim of the social enterprises should be to offer the services without any restriction to everybody belonging to the target group. The various possibilities for generating revenues will depend on the target group and the social problem itself. For example, there may be very few income-generation opportunities for providing shelter to homeless children.

Another revenue stream is membership fees. Membership fees are an attractive revenue stream when the target group can be clearly defined and the social good provided directly reinforces the characteristics of the club members' interests (Sandler and Tschirhart 1997). Examples are organizations which offer membership-only cultural events and productions or self-help groups. Other examples are organizations where the members actively support the work, such as interest groups, environmental preservation groups or research institutes (Steinberg 2007).

Sponsorships are contributions from companies which support the work but also want to generate positive publicity through their association with the social enterprise. In corporate partnerships the social enterprise provides its brand and reputation within a sponsoring agreement. However, there can also be the risk of reputational damage for the social enterprise should the corporate partner subsequently become embroiled in any controversy (James and Young 2007).

Other income streams can be prize money, income from endowment capital (Bowman et al. 2007) or penalty fees which have to be surrendered to a social organization. There are also income streams which are provided in-kind. These income streams include in-kind donations (Gray 2007) or voluntary work (Leete 2006; Preston 2007) which have a monetary value but are not provided in monetary form.

In a sample of 208 German social enterprises the characteristics and the income structure were analyzed (Spiess-Knafl et al. 2013). The distribution of the income structure is shown in the following table (Table 5.2).

Public funding in the form of fees and subsidies explains 36.2 % of total income. The survey shows that public funding through fixed fees or subsidies are an important element of the funding structure and a very scalable revenue stream. This can be seen through the fact that the larger social enterprises have a larger share of public financing. The fact that larger organizations have a larger share of total funding coming from public funding will be discussed later in the section dealing with the scaling of social enterprises.

Table 5.2 Income structure of German social enterprises. (Spiess-Knafl 2012)

Income (`000 €)	Fees (public) (%)	Earned income (%)	Subsidies (public) (%)	Donations (%)	Foundations (%)	Sponsorship (%)	Membership fees (%)	Other (%)
<50	9.0	14.3	6.8	20.9	8.1	14.3	13.1	13.6
50–100	5.3	29.9	30.0	5.3	14.1	3.8	3.8	7.8
100–250	15.3	24.0	15.2	11.7	12.8	1.3	2.4	7.2
250–500	25.8	21.2	19.5	10.9	4.1	6.2	0.6	11.5
500–1,000	18.9	30.8	27.5	6.4	5.1	2.8	2.7	6.1
1,000–5,000	33.1	20.8	16.2	2.0	4.2	5.7	0.3	17.7
>5,000	50.2	18.4	6.7	3.7	0.7	0.1	3.3	17.1
Total	20.8	21.0	15.4	10.3	7.1	8.0	5.0	12.6

Earned income contributes 21.0 % while the rest is split among donations, grants from foundations, sponsorship, membership fees and others. Nonetheless, social enterprises show a surprisingly low level of diversification which supports similar findings from other studies (Fischer et al. 2011; Foster and Fine 2007). It seems that social enterprises focus on the most promising income stream in order to reduce possible conflicts of interests between the different capital providers (Achleitner et al. in press).

This finding is in contrast to the observation that social enterprises are sometimes advised to access as many income streams as possible since increased diversification is supposed to reduce the overall volatility of the income streams. Carroll and Stater (2009) have shown that a higher degree of diversification leads to a lower degree of volatility.

Table 5.3, however, shows that social enterprises typically rely on one single primary income stream. The table shows the average amount of the primary income stream for each size category with the rather surprising finding that even small social enterprises rely on one single primary income stream. For example, social enterprises with an annual income between € 250,000 and 500,000 have on average one primary income stream (public fees) which accounts for 73.6 % the total income.

5.5 Scaling

The evidence shows that social enterprises have access to a wide range of financing instruments but given that they cannot offer the same financial terms as for-profit companies significant amounts of capital are difficult to raise. This question is especially relevant when social enterprises want to scale up their concepts and need capital to fund the expansion.

However, there also exist cases of social enterprises which are not trying to scale up their activities. This could be the case where the social enterprise is local in nature or where the founding motives of the social entrepreneur are to solve a social problem in a local context only (Barendsen and Gardner 2004).

Table 5.3 Average amount of primary income stream. (Spiess-Knafl 2012)

Income (`000 €)	Fees (public) (%)	Earned income (%)	Subsidies (public) (%)	Donations (%)	Foundations (%)	Sponsorships (%)	Membership fees (%)	Other (%)
<50	65.7	71.7	49.0	73.3	50.0	84.3	61.1	77.6
50–100	48.0	70.0	68.0	–	58.9	–	–	99.0
100–250	70.0	74.1	71.0	80.0	44.9	62.5	30.0	52.3
250–500	73.6	70.8	52.6	60.0	25.0	90.0	–	66.7
500–1,000	61.3	77.7	68.7	75.0	50.0	–	–	60.0
1–5,000	79.4	75.4	59.1	40.0	45.0	66.7	–	74.8
>5,000	66.6	82.5	44.0	50.0	–	–	50.0	64.0
Total	71.1	73.8	60.4	69.3	48.3	75.3	57.3	71.8

Within this chapter we will discuss the mechanisms and the objectives of scaling as well as the relevant financing strategies. The scaling mechanisms can be classified according to the degree of control of the business model as well as the speed of scaling. A high degree of control within the business model means that the social enterprise can control aspects of the business model such as marketing, sales or the supply chain (for an overview of the literature on business models see Zott et al. (2011)). This classification provides us with four types of scaling models which are shown in the table below (Table 5.4).

These scaling models describe the mechanisms social enterprises can use. Social enterprises can have different objectives for the scaling of the social enterprise which do not have to be mutually exclusive. These objectives are to reach economies of scale or economies of scope through providing services to additional target groups or offering the current target group additional products, thus utilizing and securing organizational capacity (Jansen 2013).

Social enterprises have two types of costs: variable and fixed costs. Variable costs accrue relative to the number of services provided and include material or personnel costs. Independent of the number of services provided, the social enterprise has to cover a certain amount of fixed costs. These fixed costs usually consist of rental expenses, management costs or fees for legal and tax-related advisory. Thus, there is an incentive to increase the number of services provided to reduce the relative amount of fixed costs per service provided.

Looking at the size of social enterprises, it can be assumed that many small social enterprises are single-product companies. They offer a certain kind of service to a defined target group. However, these social enterprises could use their access to the target group or their expertise in providing the service to expand its customer or product range and thus become a local multi-product social enterprise. They could either offer additional products or services to their target group or offer the same product to an additional target group or groups.

There is also the objective to secure a “critical mass”, to secure organizational capacity. Fixed fees paid by public authorities represent a scalable and predictable income stream but the administrative requirements necessitate that the recipient enterprise has a certain organizational size. The same is true for a social enterprise

Table 5.4 Scaling models

		Speed of scaling	
		Low	High
Control of business model	Low	Networkers	Blueprinters
	High	Localizers	Scalers

to be able to generate a real presence at conferences, fairs and other events. Once the "critical mass" is reached the financing can be switched to public funding. However, getting to this critical mass is more complicated. As shown above, there are a number of limitations to repay investors with public funding. The best way to reach a size which makes the social enterprise eligible for public funding is to seek out philanthropic capital without any repayment obligations.

The discussion of both dimensions—strategy and objective—below, will also examine which strategies are appropriate for which type of social enterprise.

5.6 Networkers

Networkers use an approach in which scaling is realized in cooperation with a network of partners. There are various forms for how this network can be structured (for an overview of the structure of networks see e.g. Estrada 2012; Newman 2010). A network strategy is an inexpensive form of scaling and increases access to resources through the use of network partners. However, it also reduces the control of the business model and is not the fastest way of scaling since interaction between the social enterprise and the network of partners has to be coordinated.

One network structure which has been discussed in relation to social enterprises is the social franchise (e.g. Heinecke and Mayer 2012). It is sometimes considered to be the most promising strategy for growth with a limited risk exposure for the social enterprise as the franchisor (Tracey and Jarvis 2007). But not every concept can be scaled through a social franchise system as this type of strategy necessitates a great number of standardized elements (Bradach 2003).

In this social franchise structure the social enterprise provides the concept as well as the relevant expertise to a franchisee which is acting independently although aligned with the mission of the social enterprise. Other forms of networks can be the coordination of international activities by the social enterprise through an umbrella approach or the coordination by the social entrepreneur of various partners in the for-profit sector to accomplish a social goal.

Examples of these types of networks are qualification programs where students act as mentors for certain pupils helping them to find an apprenticeship after school. This concept needs a strong brand for employers but also local social organizations to manage the volunteers and the coaching relationships.

Networking models generally have low capital requirements and can be financed with the operating cash flows generated through the services provided or products

sold. Equity or debt capital is rather unattractive as there are no assets and predictable cash flows.

5.7 Blueprinters

Blueprinters are social enterprises which develop an innovative blueprint solution for a social problem (Jansen et al. 2010). A blueprint solution can be a new pedagogic concept for children, an integration concept using sports or music or the employment of disabled persons using an innovative approach. The social enterprise would provide the solution to every other organization aiming to adopt this approach. This approach is also known as dissemination or open-source approach (Heinecke and Mayer 2012).

This means that a social enterprise can scale its concept more easily but also loses the control of the business model as there is no mechanism to secure the quality of the concept once it is provided to other organizations. There is also a range of innovative blueprints which are simply copied by other organizations without the social entrepreneur's actual input. Microfinance, educational programs or innovative employment concepts are easy to copy and hard to protect as there are no patents or copyrights for business models of social enterprises.

As the blueprint-type concept is easy to copy and there is no possibility to recover an investment made with debt or equity capital there must be another kind of more philanthropic capital made available. Since a blueprint solution for a given social problem can be developed with a relatively low amount of capital the financing of a blueprint solution can be provided by foundations or by individuals through donations. This seems to correlate with the fact that foundations prefer to finance innovative models.

5.8 Scalers

Scalers develop a business model which is easy to scale up and enables them to provide their products or services to an increasing range of customers. However, at the moment social capital markets offer rather limited amounts of capital for social enterprises and this in itself could limit the range for social enterprises. Not many investments in social enterprises appear to exceed the amount of USD 10 million and most are below the threshold of USD 1 million (Spiess-Knafl 2012). Compared to average investments in the venture capital arena these investments are rather small (e.g. for a comparison see Harris et al. 2012).

Given those restrictions in the fundraising process social enterprises have two options. They must either integrate digital elements in their business model which

enable them to scale the business model inexpensively, or else access public funding which is both a scalable and predictable revenue stream.

Information technology offers an opportunity to develop a business model which can be scaled inexpensively. The marginal costs of serving an additional customer are low and economies of scale are fully applicable in this case. There are no numbers available to estimate the spread of digital business models but it seems that digital elements are used widely by social enterprises. These elements can include an information platform or an online-tool to match demand and supply. In one example, a social enterprise gives teachers in developing countries an employment opportunity as they set up individual language courses via Skype.

Social enterprises often face the dilemma of wanting their services to be provided to everybody who is eligible for them and having to restrict that provision to an arbitrary selection of recipients. It is often not feasible simply with private funding and only public authorities can provide the funding needed to offer the services to the general public. Besides general funding through fixed fees or subsidies, there are various initiatives which strive to close this financing gap. They are mostly known as social-impact bonds, pay-for-success bonds or human-capital-performance bonds (e.g. Cohen 2011; Social Finance 2009). The main characteristic with these is that the payment is based on the results achieved by the social enterprise such as the number of job placements or the recidivism rate.

5.9 Localizers

Localizers are social enterprises which are based in a city or community and decide to remain in this local context. It can be an attractive strategy as contacts with public authorities, companies and community leaders are already well established and the existing administrative infrastructure can be used to offer additional services. This type of social enterprise rather relies on the economies-of-scope strategy which reduces the proportional fixed costs and allows the social enterprises to use existing know-how. Localizers have the opportunity to replicate existing concepts in their community and benefit from development efforts. In one example, a social enterprise based in a German city started to offer employment services for young individuals. Given that contacts with local authorities were well established they had regular opportunities to expand their services to other segments. Employment services can originally intend to open a restaurant and in the next step deliver meals to elderly people to ensure capacity utilization, thereby ensuring economies of scope.

If there is a business model with recurring and predictable income streams the social enterprise could use equity or debt capital to add further services to their platform. A social enterprise could also follow a hybrid strategy which means that they could subsidize one segment with the profits generated in another segment (Table 5.5).

Table 5.5 Scaling strategies

Scaling strategy	Description
Networkers	Scaling through network strategies (e.g. social franchise)
	Inexpensive scaling strategy
	Low control of business model
Blueprinters	Scaling through provision of innovative concept
	Low control of business model and quality
	Open source approach
Scalers	Development of a scalable business model with digital elements for low marginal costs
	Scaling through the use of public funding as a scalable income stream
	High control of business model
Localizers	Use of economies of scope
	Copy of innovative concepts in local context
	High control of business model

5.10 Conclusion

This book chapter discusses the different financing instruments of social enterprises and the scaling strategies they can use. A classification of scaling strategies is introduced using the degree of control of the business model and the speed of scaling.

A few research questions remain. It is not yet known what impact, if any, the financing structure has on the strategy of the social enterprise. For instance, there is some evidence that debt and mezzanine capital lowers the risk appetite of a social enterprise allowing the risk of a mission shift to remain.

Moreover, it is also unclear which financing strategy social enterprises should use during the different phases of their lifecycle. From a theoretical point of view there should be a higher degree of donation-based financing in the start-up phase and equity and debt capital financing during the later stages of the lifecycle. A life cycle financing strategy for social enterprises could then be based on donations and equity capital in the early phases and debt capital in the later stages. It also remains to research the question under which conditions social enterprises prefer equity or debt capital to donations.

References

Achleitner, A.-K., and W. Spiess-Knafl. 2012. Financing of social entrepreneurship. In *Social Entrepreneurship & Social Business,* eds. C. Volkmann, K. Tokarski, and K. Ernst, 157–173. Wiesbaden: Gabler.

Achleitner, A.-K., A. Heinecke, A. Noble, M. Schöning, and W. Spiess-Knafl. 2011a. Unlocking the mystery: An introduction to social investment. *Innovations* 6 (3): 145–154.

Achleitner, A.-K., W. Spiess-Knafl, A. Heinecke, M. Schöning, and A. Noble. 2011b. Social investment manual.

Achleitner, A.-K., W. Spiess-Knafl, and S. Volk. in press. The financing structure of social enterprises: Conflicts and implications. *International Journal of Entrepreneurial Venturing*.

Adema, W., and M. Ladaique. 2009. How expensive is the welfare state? Gross and net indicators in the OECD Social Expenditure Database (SOCX). *OECD Social, Employment and Migration Working Papers*, *92*.

Andreoni, J. 1990. Impure altruism and donations to public goods: A theory of warm-glow giving. *The Economic Journal* 100 (2): 464–477.

Andreoni, J. 2001. Economics of philanthropy. In *International Encyclopedia of the Social & Behavioral Sciences,* eds. N. J. Smelser and P. B. Baltes, 11369–11376. Oxford: Pergamon.

Bank of England. 2003. The financing of social enterprises: A special report by the Bank of England.

Barendsen, L., and H. Gardner. 2004. Is the social entrepreneur a new type of leader? *Leader to Leader* 34 (Fall): 43–50.

Belk, R. W., and G. S. Coon. 1993. Gift giving as agapic love: An alternative to the exchange paradigm based on dating. *Journal of Consumer Research* 20 (3): 393–417.

Besel, K., C. L. William, and J. Klak. 2011. Nonprofit sustainability during times of uncertainty. *Nonprofit Management and Leadership* 22 (1): 53–65.

Bishop, M., and M. Green. 2008. *Philanthropocapitalism*. London: A&C Black.

Bowman, W., E. Keating, and M. A. Hager. 2007. Investment Income. In *Financing nonprofits: Putting theory into practice,* ed. D. R. Young. Lanham: AltaMira.

Bradach, J. L. 2003. Going to scale. *Stanford Social Innovation Review* (Spring): 19–25.

Carroll, D. A., and K. J. Stater. 2009. Revenue diversification in nonprofit oranizations: Does it lead to financial stability. *Journal of Public Administration Research and Theory* 19 (4): 947–966.

CIC Regulator. 2013. Information pack: Department for business innovation & skills. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/223857/13-783-community-interest-companies-information-pack.pdf.

Cohen, R. 2011. Harnessing social entrepreneurship and investment to bridge the social divide. http://ec.europa.eu/internal_market/social_business/docs/conference/cohen_en.pdf

Crumpler, H., and P. J. Grossman. 2008. An experimental test of warm glow giving. *Journal of Public Economics* 92 (5/6): 1011–1021.

Dees, G. J. 1998. The meaning of "Social Entrepreneurship". http://www.caseatduke.org/documents/dees_sedef.pdf

Defourny, J., and M. Nyssens. 2008. Social enterprise in Europe: Recent trends and developments. *Social Enterprise Journal* 4:202–228.

Defourny, J., and M. Nyssens. 2010. Conceptions of social enterprise and social entrepreneurship in Europe and the United States: Convergences and divergences. *Journal of Social Entrepreneurship* 1 (1): 32–53.

De Oliveira, A. C. M., R. T. A. Croson, and C. Eckel. 2011. The giving type: Identifying donors. *Journal of Public Economics* 95 (5–6): 428–435.

Emerson, J. 2003. The blended value proposition: Integrating social and financial returns. *California Management Review* 45 (4): 35–51.

Estrada, E. 2012. *The structure of complex networks*. Oxford: Oxford University Press.

Fischer, R. B., A. L. Wilsker, and D. R. Young. 2011. Exploring the revenue mix of nonprofit organizations: Does it relate to publicness. *Nonprofit and Voluntary Sector Quarterly* 40 (4): 662–681.

Foster, W., and G. Fine. 2007. How nonprofits get really big. *Stanford Social Innovation Review* Spring 2007:46–55.

Gray, C. M. (2007). Gifts-in-kind and other illiquid assets. In *Financing nonprofits: Putting theory into practice,* ed. D. R. Young, 227–242. Lanham: AltaMira.

Harbaugh, W. T. 1998. What do donations buy? A model of philanthropy based on prestige and warm glow. *Journal of Public Economics* 67 (2): 269–284.

Harris, R., and A. Raviv. 1991. The theory of capital structure. *The Journal of Finance* XLVI (1): 297–355.

Harris, R. S., T. Jenkinson, and S. N. Kaplan. 2012. *Private equity performance: What do we know?* (No. w17874). National Bureau of Economic Research.

Havens, J. J., M. A. O'Herlihy, and P. G. Schervish. 2006. Charitable giving: How much, by whom, to what, and how. In *The nonprofit sector: A research handbook,* eds. W. W. Powell and R. Steinberg, 542–567. New Haven: Yale University Press.

Heinecke, A., and J. Mayer. 2012. Strategies for scaling. In *Understanding social entrepreneurship & social business,* eds. C. Volkmann, K. Tokarski, and K. Ernst, 191–210. Wiesbaden: Gabler.

Heister, P. 2010. *Finanzierung von social entrepreneurship durch venture philanthropy und social venture capital*. Wiesbaden: Gabler.

Hoogendorn, B., E. Pennings, and R. Thurik. 2010. What do we know about social entrepreneurship? An analysis of empirical research. *International Review of Entrepreneurship* 8 (2): 1–42.

James, E. 1986. How nonprofits grow: A model. In *The economics of nonprofit institutions,* ed. S. Rose-Ackerman, 185–204. New York: Oxford University Press.

James, E., and D. R. Young. 2007. Fee income and commercial ventures. In *Financing nonprofits: Putting theory into practice,* ed. D. R. Young, 93–120. Lanham: AltaMira.

Jansen, S. A. 2013. Skalierung von sozialer Wirksamkeit—Thesen, Tests und Trends zur Organisation und Innovation von Sozialunternehmen und deren Wirksamkeitsskalierung. In *Sozialunternehmen in Deutschland*, eds. S. A. Jansen, R. G. Heinze, and M. Beckmann. Wiesbaden: Springer VS.

Jansen, S. A., S. Richter, E. Hahnke, A.-K. Achleitner, W. Spiess-Knafl, S. Volk,… B. Schmitz. 2010. Eine Definition von Social Entrepreneurship.

Kerlin, J. A. 2006. Social enterprise in the United States and Europe: Understanding and learning from the differences. *Voluntas: International Journal of Voluntary and Nonprofit Organizations* 17 (3): 246–262.

Leete, L. 2006. Work in the nonprofit sector. In *The nonprofit sector: A research handbook,* eds. W. W. Powell and R. Steinberg, 159–179. New Haven: Yale University Press.

Letts, C., W. Ryan, and A. Grossman. 1997. Virtuous capital: What foundations can learn from venture capitalists. *Harvard Business Review* 75 (2): 36–44.

Light, P. 2008. *The search for social entrepreneurship*. Washington: Brookings.

Mair, J., and I. Marti. 2006. Social entrepreneurship research: A source of explanation, prediction, and delight. *Journal of World Business* 41 (1): 36–44.

Mendell, M., and R. Nogales. 2009. Social enterprises in OECD member countries: What are the financial streams. In *The changing boundaries of social enterprises,* ed. A. Noya, 89–138. Paris: OECD.

Meer, J., and H. S. Rosen. 2011. The ABCs of charitable solicitation. *Journal of Public Economics* 95 (5–6): 363–371.

Milligan, K., and M. Schöning. 2011. Taking a realistic approach to impact investing: Observations from the World Economic Forum's Global Agenda Council on social innovation. *Innovations* 6 (3): 155–166.

Moody, M. 2008. "Building a culture": The construction and evolution of venture philanthropy as a new organizational field. *Nonprofit and Voluntary Sector Quarterly* 37 (2): 324–352.

Newman, M. 2010. *Networks*. Oxford: Oxford University Press.

O'Donohue, N., C. Leijonhufvud, Y. Saltuk, A. Bugg-Levine, and M. Brandenburg. 2010. Impact investments: An emerging asset class: J. P. Morgan. http://www.rockefellerfoundation.org/uploads/files/2b053b2b-8feb-46ea-adbd-f89068d59785-impact.pdf

Preston, A. E. 2007. Volunteer resources. In *Financing nonprofits: Putting theory into practice,* ed. D. R. Young, 183–206. Lanham: AltaMira.

Rushton, M., and A. C. Brooks. 2007. Government funding of nonprofit organizations. In *Financing nonprofits: Putting theory into practice,* ed. D. R. Young. Lanham: AltaMira.

Salamon, L. M., and H. K. Anheier. eds. 1997. *Defining the nonprofit sector: A cross-national analysis*. Manchester: Manchester University Press.

Sandler, T., and J. Tschirhart. 1997. Club theory: Thirty years later. *Public Choice* 93 (3–4): 335–355.

Sinitsyn, M., and B. A. Weisbrod. 2008. Behavior of nonprofit organizations in for-profit markets: The curious case of unprofitable revenue-raising activities. *Journal of Institutional and Theoretical Economics* 164 (4): 727–750.

Social Enterprise UK. 2011. Fightback Britian: A report on the state of social enterprise survey 2011.

Social Finance. 2009. Social impact bonds, rethinking finance for social outcomes. http://www.oregon.gov/gov/docs/OEIB/SocImpactBonds.pdf

Sommerfeld, J. 2009. Die Spendenstatistik als Teil eines "Informationssystems Zivilgesellschaft": Erfahrungen, Konzeption und Umsetzung. In *Auf dem Weg zu einem Informationssystem Zivilgesellschaft*, eds. H. K. Anheier and N. Spengler, 41–51. http://www.ziviz.info/fileadmin/download/Bd1_Zivilgesellschaft%20in%20Zahlen.pdf#page=45

Sommerrock, K. 2010. *Social entrepreneurship business models: incentive strategies to catalyze public goods provision*. New York: Palgrave Macmillan.

Spiess-Knafl, W. 2012. Finanzierung von Sozialunternehmen—Eine empirische und theoretische Analyse. http://mediatum.ub.tum.de/?id=1098776

Spiess-Knafl, W., R. Schües, B. Schmitz, T. Scheuerle, and S. Richter. 2013. Eine Vermessung der Landschaft deutscher Sozialunternehmen. In *Sozialunternehmen in Deutschland,* eds. S. A. Jansen, R. G. Heinze, and M. Beckmann, 21–34. Wiesbaden: VS Verlag für Sozialwissenschaften.

Steinberg, R. 2007. Membership income. In *Financing nonprofits: putting theory into practice,* ed. D. R. Young, 121–155. Lanham: AltaMira.

Steinberg, R., and B. A. Weisbrod. 1998. Pricing and rationing by nonprofit organizations with distributional objectives. In *To profit or not to profit: The commercial transformation of the nonprofit sector,* ed. B. A. Weisbrod, 65–82. Cambridge: Cambridge University Press.

Tracey, P., and Jarvis, O. 2007. Toward a theory of social venture franchising. *Entrepreneurship Theory and Practice* 31 (5): 667–685.

Vesterlund, L. 2006. Why do people give? In *The non-profit sectdor: A research handbook*, eds. W. W. Powell and R. Steinberg 2. ed., 568–587. New Haven: Yale University Press.

Weisbrod, B. A. ed. 1998. *To profit or not to profit: The commercial transformation of the nonprofit sector*. Cambridge: Cambridge University Press.

Yunus, M. 2006. Social business entrepreneurs are the solution. In *Social entrepreneurship: New models of sustainable social change,* ed. A. Nicholls. Oxford: Oxford University Press.

Zahra, S. A., E. Gedajlovic, D. O. Neubaum, and J. M. Shulman. 2009. A typology of social entrepreneurs: Motives, search processes and ethical challenges. *Journal of Business Venturing* 24 (5): 519–532.

Zott, C., R. Amit, and L. Massa. 2011. The business model: Recent developments and future research. *Journal of Management* 37 (4): 1019–1042.