

# Is Crowdfunding an Alternative Financial Model for Social Enterprises?

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**Abstract.** Social enterprises face difficulties in financing. Because investors concentrate too narrowly on risk and return, social enterprises may have difficulty competing with commercial enterprises for investment capital. In this context, loans and equity financing have not been adequately examined, and their growing importance in financing enterprises makes it important to understand their implications for social enterprises. We discuss the fact that crowdfunding represents values that are attractive to social enterprises. In addition, crowdfunding sometimes offers higher value or more capital to social enterprises, compared to other sources of funding. We find that several benefits are particularly important in the start-up phase of a business. However, crowdfunding can also result in greater stress for the management team and can take time and resources. Entrepreneurs must also take into account factors such as public discomfort when campaigns have failed.

**Keywords:** Alternative model, Crowdfunding, Social enterprise, Social entrepreneurship.

## 1. INTRODUCTION

Social entrepreneurship is a real fundamental movement that needs to be maintained and amplified given the low effectiveness of government entities in improving the standard of living of disadvantaged social sectors. The large-scale actions of these entities have been hampered by a complex bureaucracy and political alternation, which have limited the beneficial effects of social entrepreneurship, (Palacios-Marqués (2019)). Social enterprises are qualified as hybrid organizations because they have a dual mission of creating social value and financial sustainability, (Doherty and al. (2014); Pache and Santos (2013)).

These organizations have a social mission, with their activities funded through the use of market mechanisms (Ebrahim and al. (2014) ; Wilson and Post (2013)) and their main objective is to create social value rather than increasing shareholder wealth (Austin and al. (2006)). The reconciliation of social and financial objectives in decision-making is presented as a major internal challenge in social enterprises, (Battilana and Lee (2014)). Particularly, several authors have warned against the emergence of a mission drift, which would lead an organization to deviate from its original mission or objectives, (Ebrahim et al. (2014); Ramus and Vaccaro (2014)).

In the context of social enterprises, mission drift is often discussed as the erosion of social objectives in favor of commercial and financial performance, (Doherty et al. (2014)). However, there may also be a reverse situation in which focusing too much focus on social objectives and neglecting financial objectives can lead to business failure, (Cornforth (2014); Tracey et al. (2011)). Several causes of mission drift have been identified in the literature, (Cornforth (2014); Jones (2007)), but a high degree of dependence on a single or limited number of stakeholders in the external environment is frequently cited as one of the main reasons for mission drift, (Bennett and Savani (2011)).

Indeed, as hybrid organizations placed between the for-profit and non-profit sectors, Social enterprises don't have a dominant stakeholder and face the challenge of matching the interests of many stakeholders such as beneficiaries of their social mission, their clients, donors and governments, (Ebrahim et al. (2014); Pache and Santos (2010)). A collaboration with these stakeholders is crucial to gain legitimacy and to access (amongst other financial and human resources) the environment, ((Battilana and Lee (2014); Doherty et al (2014); Miller et al (2012)), but can also lead to mission drift when stakeholder requirements are confronted with conflicts and social enterprises must decide which demands they focus on, (Ebrahim et al. (2014)).

The growth of social enterprises around the world in many different sectors of the economy (Short et al., 2009; Santos, 2012; Zahra & Wright, 2016) has led to considerable growth in studies and publications in recent years (Noruzi and al., 2010; Huybrechts and Nicholls, 2012; Santos, 2013). However, little work has been written on the financing of this type of entrepreneurship (López-Cózar and Priede, 2015). Similarly, the concept of crowdfunding has received limited attention in the academic literature (Belleflamme and al., 2013; Ahlers and al., 2015), let alone its use in financing social enterprise (Lehner and Nicholls, 2014). Therefore, this paper contributes to bridg this gap in the literature by analyzing the use of crowdfunding by social enterprise and its relevance to addressing their financing needs.

Clearly, this is an important issue, as social enterprises may have different business models, ownership structures, and financing (Zahra and Wright, 2016); and Access to finance is one of the major problems they have to face (Melián and al., 2011; Valcárcel, 2012; Calic and Mosakowski, 2016).

In a study conducted in France, Ducci and al. (2002) affirmed the growth of social enterprises in that country, but pointed out several obstacles that they face. The difficulty of obtaining funding is a major one among these difficulties. Therefore, the general objective of this article is to examine social entrepreneurs' perception of

crowdfunding and its level of use in social enterprises. In particular, the article will explore the main factors that motivate or obstruct the use of crowdfunding, the accessibility and affordability of relevant information, the effectiveness of crowdfunding in financing social projects, and how best to enhance the promotion of crowdfunding in order to increase its use in the future. The article first examines the concept and importance of social entrepreneurship and assesses the different sources of financing available to social entrepreneurs. The suitability of crowdfunding as an alternative to business financing is also examined.

### 1.1. Defining the Concept of Social Enterprise

Social entrepreneurship has received increased attention from the general public and researchers in recent years (Renko, 2012). The different perceptions of social entrepreneurs have led to a variety of definitions (Abu-Saifan, 2012), which has stimulated researchers to find the defining elements of social entrepreneurship (Christie and Honig, 2006).

The most debated element of this concept is the emphasis on social versus financial goals. Some scholars emphasize the importance of social mission and argue that the primary mission of a social entrepreneur is to fulfill their social purpose (Abu Saifan, 2012) and improve the well-being of society (Zahra, Rawhouser, Bhawe, Neubaum and Hayton, 2008). Dorado (2006), on the other hand, argues that social entrepreneurs are motivated by market opportunities where the real reason for adopting a social orientation is financial gain. Finally, Thompson and Doherty (2006) see orientation as a necessity for social enterprise, rather than as its primary goal.

Social enterprises must seek commercial solutions to social problems and act in an entrepreneurial way to ensure sustainability (Thompson & Doherty, 2006). Nevertheless, social enterprise differs significantly from commercial enterprise, and its purpose is always to create social value rather than personal wealth (Chell 2007; Keohane, 2013).

Today, social enterprises increasingly perform typical industry activities and are becoming equal players in the market game, competing with commercial enterprises for clients and resources, (Siegnier, M and al. (2018)). Furthermore, engagement in social entrepreneurship is a challenge in personal and professional life. Not only because there is no permanent source of funding, no guarantee that a business idea will work in practice, and no guarantee of stability, but the boundary between work and private life is becoming blurred, (Praszkier and Nowak (2012)).

All of this translates into increased interest in running a social enterprise, as the possibility of achieving organizational goals depends largely on participatory governance. In the literature several researchers, (Economist (2009); Strom (2010); Battilana and al (2015); Jay (2012); Pache and Santos (2013); Kerlin (2006); Defourny and Nyssens (2008); Bacq and Janssen (2011); Zeyen and al (2013); Wilson and Post (2013); Rahdari, A (2016); Roy, M and al (2019); Cheah, J (2019); Bobby and al (2018); Leung and al (2019)) perceive social enterprise as a more effective form of organization.

In the non-profit sector, while other firms include themselves in the for-profit sector, emphasizing at the same time that they are responding to emerging social needs in the marketplace, (Harding (2004)). Pearce, (2003), defines social enterprise as "all economic entities that have a social purpose, are not oriented toward the generation and future and the distribution of capital, and have a democratic and measurable structure based on participatory governance" (Pearce (2003)).

In other words, social enterprises are hybrid organizations established for social purposes that use a for-profit business model to generate the financial resources needed to achieve their social missions (Reis (1999); Thompson (2002)). In practice, social enterprises differ in the extent to which they adhere to the economic aspect of their social missions, which is an ongoing process, (Stevens and al. (2015)). Social enterprises use entrepreneurship and strategy to achieve their social goals for the benefit of society. The growth of social enterprises has been a key component of economic activity in both developed and developing countries.

The balance between financial and social objectives is already highlighted in an early definition by Dees (1998), a leading researcher in the field of social entrepreneurship, who argues that a social enterprise should not be entirely philanthropic or commercial in order to achieve a productive balance (Dees, 1998). Rather, the importance lies in understanding the spirit of the term and the outcome rather than in seeking an "idealized" definition (Dees, 1998).

### 1.2. Social Enterprise Financing

The importance of financing is obvious and is a key determinant of the possibility of creating enterprises to survive and grow (Cassar, 2004), but it is also a major obstacle for social entrepreneurs (Lehner, 2013). The lack of funding for social enterprises is described as one of the main drawbacks for commercial enterprises (Bugg-Levine and al., 2012). In addition, businesses can expect a shortage of resources throughout their existence similar to what conventional entrepreneurship would experience only at the beginning of its life cycle (Gundry, Kickul, Griffiths and Bacq, 2011).

These problems hinder social enterprise creation and growth, making it one of the most pressing issues for social enterprises (Calic and Mosakowski, 2016). To appreciate the underlying problems in financing social enterprises, it is necessary to begin by recognizing that the goal of a social enterprise is not primarily profit

maximization (Martin, 2015). It has been argued that many social enterprises are not profitable enough to attract investors (Bugg-Levine and al. 2012). Social enterprises can be successful in generating high value and environmental impact, but they still face problems in covering the expenses that come with securing funding (Bugg-Levine and al., 2012).

The start-up phase is very high risk, which means that it can be difficult for investors to meet risk-adjusted return requirements, as social enterprises focus on social impact rather than wealth creation (Lyons and Kickul, 2013). Socially, companies may not find people to bill for their services, since value is created for society as a whole, rather than just a certain group of clients (Lyons & Kickul, 2013). These challenges create unique problems for both investors and social entrepreneurs.

Social enterprises may have to compromise their social mission to achieve profitability goals, to attract the necessary funding (Dacin, Dacin and Matear, 2010). This can lead to a trade-off between social mission and profits, which compromises the mission of achieving social impact (Lyons and Kickul, 2013). Another aspect related to funding challenges is the problem of measuring social impact (Kickul and Lyons, 2015).

In other hands, investors do not get an appropriate measure of what the return on investment is (Dacin and al., 2010). This is a big problem for investors, who naturally want to have a precise idea of the impact of their investments (Kickul and Lyons, 2015). Social enterprises generally try to maximize long-term value and establish long-term effects, while investors generally have a shorter-term perspective. (Lyons and Kickul, 2013).

### 1.3. Mutual Funding Sources for Social Enterprises

To create a social enterprise, an entrepreneur's own savings are usually the most common source of financing. In addition, funds from family and friends, known as 3Fs (family, friends and fools) are often used, being individuals who, motivated by their personal relationship with the entrepreneur, agree to contribute funds to the project, with the idea of supporting the initiative, rather than obtaining high financial returns. While social enterprises have a funding problem, capital is provided from a variety of sources. A simple division can be made into business investment and financing without the requirement of financial return. The latter can be government grants and philanthropic foundations, or in the form of individual or corporate donations (Lyons and Kickul, 2013; Clarkin and Cangioni, 2015).

Commercial financing typically involves loans and equity from venture capitalists, business angels, lending institutions, or community financing (Lyons and Kickul, 2013). In the early stages of a social enterprise, self-financing of the entrepreneur's own resources or investment by people closely associated with the entrepreneur is common, although this is a rather restrictive approach from a growth perspective (Bergamini and al., 2015).

Donations have always been the primary source of funding for social initiatives (Martin, 2015), but they come with a degree of unpredictability, which can limit the growth and effectiveness of social enterprises (Brandstetter and Lehner, 2015).

Another problem is that charity and grants tend to focus on providing seed capital, but not capital for expansion (Lyons & Kickul, 2013). Social enterprises face funding challenges. Given the focus on maximizing social impact rather than profitability, it may seem difficult to compete with commercial enterprises in terms of profitability and risk. This is sometimes due to monetization problems. In addition, the lack of effective measurement of social impact makes it difficult for investors to know what they are receiving in return for their investment. With respect to the current funding model for social enterprises, we have identified several sources.

While donations have traditionally funded a majority of social initiatives, this is a limitation for social enterprises. Venture capital, however, looks for businesses with high growth potential and has a short-term focus, which may be unsuitable for social enterprises. In the case of banks, loan guarantees and differences in mentality can be obstacles.

As a result, social enterprises are pursuing new financing strategies, as traditional forms of financing do not fully meet the needs of social enterprises (Kickul and Lyons, 2015). Another means of financing social enterprises is venture capital and business angels, which have become one of the main instruments for financing enterprises in advanced economies. They provide a time-limited minority investment in the equity of a company by an independent investor (a company in the case of venture capital and an individual in the case of business angels) who may also participate in management decisions, at medium or low risk. The investor's ultimate objective is to obtain capital gains from the sale of the participation after the success and development of the financed project. It is a stable source of and therefore a very interesting tool at any stage of the project life cycle.

In addition, these investors can offer their expertise, knowledge and professional contacts. However, since the objective is a return on investment, they are often very demanding in terms of the skill levels of entrepreneurs and their expectations for business growth, in many cases presenting difficulties for young, inexperienced and socially oriented companies. In recent years, a range of other financing options for start-ups has emerged.

### 1.4. Crowdfunding is an Alternative Financial Model for Social Enterprise

Crowdfunding, also called collective or mass financing, is a new approach to financing a range of initiatives such as businesses, cultural activities, social projects...

Allowing the company to solicit funds from a large number of people, each of whom typically provides a limited amount (Belleflamme and al., 2014; Mollick, 2014). It is an open offer, generally posted on a website, and can be made with or without a counter-offer (Kleemann and al., 2008; Schwienbachery and Larralde, 2010). Basically, crowdfunding is about reaching a large audience, where a large number of people, known as a "crowd", help finance projects and/or businesses (Belleflamme and al. 2014).

Typically, the Internet is used to connect individual investors with the investment opportunity, without the intervention of intermediaries (Schwienbacher and Larralde, 2010). Thus, companies that would normally depend on a few highly sophisticated investment institutions for their financing, can instead draw from a larger number of funders, with each person contributing a relatively small amount. (Belleflamme and al. 2014).

Thus, these contributions may have the character of subsidies or, Conversely, provide some financial compensation for the risk taken (Morales and al., 2012). A crowdfunding process normally includes three types of participants: the entrepreneur, the group of individuals who choose to contribute funds to support the initiative, and the technology platforms that enable contact between them (Bruton and al., 2015). Based on the goal of those involved in funding the project, there are two types of crowdfunding (Wardrop and al., 2015).

The first type, called reward or donation-based crowdfunding, occurs when participation is motivated by the desire to achieve an expected social outcome, as may be the case for humanitarian or solidarity projects, as well as cultural, sports and other community initiatives. Participants may or may not receive symbolic compensation such as a copy of the future product, some sort of promotional gift or public recognition, and perhaps a return on the initial investment after a period of time. (Morales and al., 2012).

The second type is "equity crowdfunding", characterized by the involvement of agents with strict investment behaviour and motivated by the expectation of financial return (Ahlers and al., 2015). For example, participants may be offered shares or shares in the financed company, or a certain percentage of profits. However, there is also the possibility of receiving interest on the amount provided and the recovery of the amount invested after a certain period of time.

The financing of social enterprises is an emerging area of research in the literature. Lehner (2013) affirms that academic research in this area is virtually non-existent and that among alternative financing for social enterprises, crowdfunding in particular is not studied (Bergamini and al., 2015).

The importance of the initiative's social and economic objectives (Meyskens and , Bird, 2015). Whereas lending based crowdfunding is the most widely used form of crowdfunding for commercial entrepreneurship ventures, reward-based and especially donation-based crowdfunding are the most widely used forms in the case of social entrepreneurship ,(Bernardino, S.; Santos, J.F, 2016) According to the Global Impact Investing Network 2018, crowdfunding platforms increasingly attract investors who are interested in profitability as well as the social and environmental impact of the projects they invest in.

## 2. CONCLUSION

Social enterprise can be seen as an alternative to shareholder capitalism. It must nevertheless renew its practices and opt for more democratic governance. At a time when the excesses of shareholder capitalism reveal the need to better take into account the interests of the various stakeholders in the life of companies (employees, local authorities, etc.), many turn to social entrepreneurship to find an answer: social enterprises do not aim at maximizing their profits but rather at meeting the needs of their adherents, associates or members, and their governance is prescribed democratic.

However, these structures do not always take into account the interests of all the stakeholders. Moreover, from theory to practice, the passage is sometimes sinuous and social enterprise must also do a serious work on itself to become exemplary in matters of democracy. The objective of this article is to determine the behavior of social enterprises with regard to the different theoretical approaches to governance in order to examine which one makes the best account of this problem in the social enterprises.

As an alternative form of financing, crowdfunding represents a new form of partnership that is especially well suited and accessible to social entrepreneurs. However, despite its interest in social entrepreneurship, studies on crowdfunding are still rare. In addition, most studies have concentrated on the project creator or funder; very few focused on intermediaries. We have addressed this gap in the literature by conducting a case study on the processes, activities, and mechanisms that intermediaries use to minimize the risks borne by creators, funders, and intermediaries themselves.

The purpose of this paper was to find the major advantages and disadvantages of lending and equity crowdfunding for social entrepreneurship, by drawing from the experiences of social entrepreneurs. Evidence affirms that nine different advantages of crowdfunding are important for social entrepreneurs. Correspondingly, five different disadvantages are revealed as important concerns for social entrepreneurs.

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