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How do Social Enterprises Manage Financing Barriers? Evidence from China

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Abstract: Social entrepreneurship has dual objectives, integrating non-profit goals and market-based techniques to offer new solutions to social issues. The concept was introduced to China in the early twenty-first century and has been evolving greatly since then. There are various barriers preventing social enterprises from adopting diversified financing instruments. Most social ventures in developed countries present an excessive reliance on grant financing. However, our understanding of how social entrepreneurs are managing financing barriers in the social context of China, an emerging economy with a strong central government, remains rather fragmented. This paper fills the gap in the literature by using a qualitative case study approach to analyze the solutions of three social enterprises in the Chinese social context to overcome financing difficulties.
Keywords: Social Enterprises; Finance; Barriers

1. Introduction

Social entrepreneurship is a complicated realm of academic study. The debates about its definition have lasted for decades. [1] One aspect that all definitions have in common is their pursuit of both social and commercial outcomes. Because of their profitability targets, social enterprises are believed to be less dependent on grants than traditional not-for-profit organizations and they can get capital from external financial institutions, such as banks. [2] However, the shortage of funds is still a key challenge that social enterprises face. And despite some scholars arguing that the financing market for social enterprises has become nearly mature and the financing model has changed toward being more reliant on commercial banks, based on the research of Sunley and Pinch, social ventures in developed countries continue to rely on donations and lack the diversity of financing sources. [3-5]

Social enterprises in China are less mature than those in developed countries.[6] The potential for social enterprises to expand is significant in China. Although China's economy has grown phenomenally in recent decades, public social services have been strained. This is due not only to the fact that China has the largest population but also to the massive rural-urban migration and the ill-structured nature of public health services. Social enterprises are expected to better address those issues that traditional organizations have struggled to solve. [7]

Chinese social entrepreneurship faces financing problems that hinder its growth as well. [6] For over half of China's nonprofit organizations, the lack of funding is the largest issue. [8] China has distinctive social circumstances. For instance, China is an emerging economy with an immature market. And the government-led social order might indicate more regulation of the social innovation market. [2] All these factors may guide Chinese social entrepreneurs to choose a different method to manage difficulties in financing. Unfortunately, there is currently a lack of study on Chinese social enterprises' financing. Most studies on Chinese social entrepreneurship focus on the process and motivation of its development. [9] This paper will fill the gap, providing an analysis of how Chinese social ventures overcome financing constraints.

2. Literature Review

2.1 The conventional financing instruments for social entrepreneurship

Social enterprises rely on two different kinds of funding sources. They can raise capital from the public, such as through initial public offerings, and from private funds, including incurring debt to banks or other official financial institutions. [10]

Grants and foundations are the primary funding source for social entrepreneurship. Instead of expanding social ventures' operations, grants are mainly utilized to support operations. The non-repayable characteristic of grants is crucial for social enterprises. Nonetheless, the short-term maturity and rigidity of grants restrict their effectiveness. [11]

Debt is another financing option for social ventures. The advantages of debt over grants are manifold. First, the application for debt is less time-consuming. Second, debt has more flexible conditions, comes with fewer reporting obligations, and gives the borrower more autonomy. Moreover, it assists in building scalability. [12] However, since debt financing requires interest repayments, it is normally not the optimal option for social enterprises. [11]

Social ventures can raise capital through equity financing as well. Given the nature of equity investors as pursuing lucrative businesses, social entrepreneurs who seek social missions are unwilling to relinquish control of their organizations to investors. [12] Therefore, it is less attractive. And the lack of fully operational markets for social enterprises' equity reduces its liquidity, further diminishing its appeal.

2.2 The financing barriers to social enterprises

One financing problem is the conflicts of interest frequently seen between social entrepreneurs and financial institutions. Financial institutions focus on financial achievement that can contradict the social achievement that social entrepreneurs seek, while grantors are considered to understand the social mission. [13,14]

Meanwhile, several barriers preclude social enterprises from accessing capital from financial institutions. First, the financial return of social ventures hardly meets the standards of external financing. [12] Because the achievements of social entrepreneurship are normally suitable for qualitative instead of quantitative measurement, the normal performance assessment standards are inapplicable, deepening the disconnect between the two parties. [15] In addition, the absence of intermediaries in this market adds difficulties to communication. [13,14]

Inadequate capital raising has been regarded as restricting the development of social ventures. Since they attempt dual targets, these organizations need to be circumspect in choosing financing strategies. [12] The prominent advantages of grants and obstacles in attaining other investment sources determine social enterprises' preference for grants. It has been observed in developed countries that social ventures tend to largely rely on grants over other financial resources. [5]

2.3 Social enterprises and social investment in China

The lack of consensus on a definition of social entrepreneurship in China leads to continuing debates on its organizational nature. [8] In contrast to the nature of Chinese social enterprises, its financing market does not get sufficient academic attention. A small number of papers discuss the issue, primarily about government grants and venture philanthropy.

As a state-led civil society, it is not surprising to find that the state has played an important role in promoting social entrepreneurship in China. The Chinese government has enacted several regulations to relax restrictions on financing resources and allow more entities to participate in the financing market for social entrepreneurship. [8,9]

More studies start to notice the emergence of venture philanthropy in China. John and Emerson expect that the next decade will be a time of rapid growth for venture philanthropy in Asia-Pacific countries. [16] New Philanthropy Partners (NPP) is a pioneering Chinese organization adopting the venture philanthropy model to foster social entrepreneurship. It is worth noting that international institutions also help to nurture social enterprises in China with venture philanthropy strategies, such as LGT Venture Philanthropy.[8]

Nonetheless, there is a paucity of research on Chinese social enterprises' response to financing difficulties. And the aim of this paper is to fill this gap.

3. Research methods

This paper uses the qualitative case study methodology. This methodology allows researchers to perform a thorough investigation of complex phenomena within a particular setting. [17,18]

3.1 Study context and sampling

This study examines how social enterprises in China respond to financing problems. A determined sampling method was utilized to recruit Chinese social ventures that adopt different methods to overcome the funding problems. Meanwhile, they need to be social enterprises with impact and representation.

This paper conducts a qualitative case study of three Chinese social enterprises. Canyou China is one of the large social enterprises in China, with more than 40 subsidiaries and over 5,000 employees. Chongho Bridge is one of the leading enterprises in microfinance in rural China. And Hongdandan Service Center is a typical example of a traditional non-profit organization transformed into a social enterprise.

3.2 Data collection and analysis

The sources of relevant information and data are primarily from the three social enterprises' publicly available information as well as secondary data from public social media and previous scholarly research. [19-21]

I adopted an inductive approach to conducting a qualitative content examination to identify (i) the main business and social targets that the three social enterprises are trying to accomplish; (ii) how the three social enterprises overcome financing difficulties. [22]

The first step was to repeatedly read and code all the information and data. Next, I organize the codes into categories, and then group related or comparable categories to form themes. From codes to categories to themes, this process generates an analysis with an advancing extent of abstraction and depth. The coding procedure was identified and managed in Excel 2016 without the use of any data analytic software.

4. Results

4.1 What are the main business and social targets of the three social enterprises?

4.1.1 Canyou China

Canyou China is a social enterprise dedicated to solving the employment problem of people with disabilities, providing stable employment opportunities for disabled people in high-tech areas such as software development, e-commerce, and life sciences.

4.1.2 Chongho Bridge

Chongho Bridge is a comprehensive agricultural assistance institution focusing on serving rural micro customers, aiming to help rural revitalization and prosperity by providing financial and public welfare assistance services.

4.1.3 Hongdandan Service Center

As a professional organization for helping the blind, Hongdandan Service Center is committed to providing products and services for visually impaired groups through narratives and advocating for society to create an inclusive and supportive environment for visually impaired groups.

4.2 How do the three social enterprises overcome financing barriers?

4.2.1 Canyou China

Canyou China's initial funding source is the founder's savings. The company has been financed primarily by profits from its operations. Meanwhile, Canyou has made equity financing. Its subsidiaries Canyou Software and Canyou Philanthropic Electronic Commerce are listed on the National Equities Exchange and Quotations (NEEQ).

Although the enterprise claims that it has not taken any grants from the government, the government's policies alleviate the company's financial pressure. An important part of the enterprise's revenues is from government purchases. And the enterprise enjoys high tax benefits because more than 95% of the employees are disabled.

4.2.2 Chongho Bridge

Chongho Bridge relied on government funding in the early stage of development. In 2006, the microfinance program department of China Foundation for Poverty Alleviation (CFPA), which then became Chongho Bridge, obtained its first bank loan from China Development Bank.

From then on, the enterprise has built up a reputation, generate income independently, and undergone a commercial transformation. Thus, Chongho Bridge has become one of the largest institutions operating in the rural microfinance sector in China, attracting the attention of various capitals, such as Ant Financial, High Impact Capital, and OTPP.

4.2.3 Hongdandan Service Center

The funding sources for Hongdandan are primarily philanthropy and grants. Donations are the most important source, accounting for 84% of all revenue in 2021. Its service revenue has massively increased from RMB 25,120 in 2020 to RMB 585,574 in 2021.

5. Discussion

This paper adopts a qualitative case study method to explore how Chinese social enterprises overcome financing difficulties, focusing on three Chinese social enterprises that rely on their operating profits, financing from the public market, and donations and government grants respectively to raise capital to support their development and expansion.

A portion of my findings is in line with previous studies. Unsurprisingly, the government has an important influence on the financing process of social enterprises in China. [9] For Chinese social enterprises, grants and government purchases are crucial sources of funding for the enterprises in the early development process. In the later stages of development, government policy inclination and support are also significant factors in enhancing the competitiveness of social enterprises, such as favorable tax treatment and support for specific projects like poverty alleviation programs.

Meanwhile, the benefits and challenges of different financing methods for social enterprises are also reflected in the cases. Philanthropy and grants keep social enterprises' cost of capital low and can satisfy the capital needs of daily operations. [11] But they do not help social enterprises expand further. Debt financing can raise a great number of funds, but it results in a high cost of capital, which will further affect the company's profits. Equity financing often raises doubts about the pursuit of social enterprises. [11,12] A model in which funding sources are highly dependent on their profits ensures that the operating strategies and goals of social enterprises are not influenced by external capital, and they are firmly committed to social goals. However, the problem with this approach is that the social enterprise needs to compete with other commercial enterprises. In the event of operational difficulties, it will be difficult to sustain the enterprise's growth. And it cannot be denied that most social enterprises are limited in some aspects of their competitiveness because of social targets. In the case of Canyou China, for example, the average level of education and productivity of its employees, which is important for high-tech industries, is lower.

My analysis shows that although different financing methods may present various opportunities and challenges for social enterprises, improving the profitability and competitiveness of social enterprises is an effective way to manage financing barriers. First, focusing on the development of their profitability can enable social enterprises to gradually achieve a model that can rely on their profits to operate and gradually reduce the need for external capital. In the absence of an improvement in the external financing environment, the difficulty of financing can be bypassed by improving the competitiveness of the enterprise and obtaining more sufficient funds from its operations. This approach is easier for social enterprises in highly profitable or promising industries, such as Internet-related industries. Additionally, by enhancing their competitiveness social enterprises can attract external capital investment, and once they have gained investment from first-tier investment institutions, subsequent financing will be smoother and more capital will pay attention to the social enterprise, which will further expand the source of funding. Furthermore, for small and medium-sized social enterprises that are reliant on social donations and government grants, if they want to reduce their dependence on such limited and unstable financing methods but still have difficulties in obtaining external financial institution funding, focusing on improving the quality of their business products and services and enhancing their profitability is a useful strategy.

5.1 Limitations

The following limitations should be considered when interpreting this study. This paper selects only three Chinese social enterprises as samples, which is a small-sized sample with limitations in terms of industry and size of enterprises, thus the results in this paper may not be generalizable to other Chinese social enterprises.

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