Hybrid Social Enterprises:

Rationale, Challenges and Impact

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ABSTRACT

There is a growing interest in Social Enterprise in South Africa driven by perceived advantages that Social Enterprise has over the government in efficient delivery of services; over conventional business. The desire to combine a social and commercial business model has led to creative ways to structure an enterprise, often known as a Hybrid model, because it combines the non-profit entity with a for-profit subsidiary. The for-profit allows an enterprise to facilitate investment, while the non-profit can facilitate grant capital and provide non profit-making services to a community.

The research analysed five Social Enterprises in South Africa that went down this route to seek a better understanding of the rationale for Social Enterprises to move to the Hybrid business model, the challenges faced when moving to the model and whether the move to the Hybrid model had the desired impact.

It was found that the justification for wanting to move a Hybrid business model was a way for Social Enterprises to issue shares. Issuing of shares allowed the Social Enterprises to attract private investors and incorporate staff as shareholders. Another reason for the move was for the ability to become more self-sufficient which meant that their strategy did not need to be shaped by the priorities of prospective funders.

The research found that there were three main challenges with establishing and maintain a Hybrid business model. These related to getting stakeholders to understand the model and agree to participate, the process was very time consuming process which could take your eye of other more pressing needs and that the costs involved in moving to Hybrid model were quite substantial.

The final part of the research looked at what was the impact of the move. The findings show that the Social Enterprises were able to access alternative sources of funding which included Bank and Enterprise Development funding. This allowed the Social Enterprises to become self sustainable, independent and achieve surpluses. The move raised the Social Enterprises profile and made the organisations more marketable. None of the Social Enterprises reported mission drift after moving to the Hybrid business model. Overall the Hybrid model allowed them all the social enterprises to reach more of their constituents by enabling them to scale up their operations and create sustainability of their programs.

THE DECLARATION

I Daryl Rajah, declare that this research report is my own, unaided work. It is submitted in partial fulfilment of the requirements for the degree of Master of Business Administration in the University of Witwatersrand, Johannesburg. It has not been submitted before for any degree or examination in this or any other university.

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Daryl Rajah

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Date

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1.1 Purpose of the study

The purpose of this research is to seek a better understanding of the reasons that make non-profit Social Enterprises create a for-profit subsidiary and for-profit Social Enterprises create a non-profit subsidiary (hence forth referred to as moving to a Hybrid business model). This report will also look to understand the challenges that a Social Enterprise would face in moving to a Hybrid business model and whether the new business model has had the desired impact.

1.2 Context of the study

A Social Enterprise is any business venture created for a social purpose to reduce a social problem or market failure, while using a financially sustainable business model with mechanisms for ensuring accountability to its beneficiaries (Alter 2004).

The growing practice of Social Enterprise is fuelled by non-profit organisations' quest for sustainability, particularly in current times when support from the traditional philanthropic and governmental sources is declining leading to increased competition for available funds. Social Enterprise enables non-profit organisations to expand vital services to their constituents while moving the organisation toward self-sufficiency. A non-profit organisation can only become a going concern by establishing an independent means of financing (Alter 2006).

There is a growing interest in Social Enterprise in South Africa, which can be seen by the increase in activity in the space. The impetus for this interest is in part driven by perceived advantages that Social Enterprise has over the government in efficient delivery of services; over conventional business relating to questions of trust, accountability, and purpose; and over charities and NGO's due to financial sustainability and access to capital (Fury 2010).

There is anecdotal evidence which suggests that the idea of a "social economy" is gaining a higher profile in the South African government, with discussions around the role of the "social economy" being tabled at Cabinet meetings. Social Enterprise is seen as a part of the "social economy". There are also steps being made by the Small Enterprise

Development Agency (SEDA), the National Youth Development Agency (NYDA) and other government bodies to better understand and support Social Enterprise development and social entrepreneurship (Fury 2010).

In addition, South African Minister for Economic Development, Mr Ebrahim Patel, has called for a stronger support agencies and training academies for social entrepreneurs, noting that Social Enterprises have the potential to contribute to the government's drive to create five million jobs in nine years (I-Net Bridge 2011).

The choice of for-profit or non-profit entity has become a popular topic among those who are interested in bringing together social mission and business practices. Entrepreneurs want to figure out the most advantageous legal structure for their social mission activities and philanthropists want to make sure they are not ignoring innovations in social change efforts (Gair 2005).

Non-profit social entrepreneurs often struggle to scale up their operations because they do not have adequate access to growth capital, distribution systems and infrastructure that is readily available to conventional businesses (Clinton 2009). In a recent study of the emerging fourth sector, social entrepreneurs reported that their most pressing challenge was gaining access to investment capital (Kelley 2009). Rather than accepting these limitations, many social entrepreneurs are increasingly incorporating traditional business structures and strategies to achieve a social bottom line (Clinton 2009).

The desire to combine a social and commercial business model has led to creative ways to structure an enterprise, often known as a Hybrid model, because it combines the non-profit entity with a for-profit subsidiary. The for-profit allows an enterprise to facilitate investment, while the non-profit can facilitate grant capital and provide non profit-making services to a community (Clinton 2009). This study will aim to better understand the rationale for South African Social Enterprises changing to a Hybrid model, the challenges involved and the eventual outcome.

1.3 Problem statement

1.3.1 *Main problem*

To better understand the rationale, the challenges faced and the impact of a Social Enterprise in South Africa moving to a Hybrid business model.

1.3.2 *Sub-problem 1*

The first sub-problem is to understand the rationale for a Social Enterprise to move to a Hybrid business model.

1.3.3 *Sub-problem 2*

The second sub-problem is to understand the challenges faced by a Social Enterprise in creating and maintaining a Hybrid business model.

1.3.4 *Sub-problem 3*

The third sub-problem is to understand whether creating a Hybrid business model has had the desired impact.

1.4 Significance of the study

As social entrepreneurs view the landscape of potential funding available to them they inevitably begin to assess their options and opportunities for both non-profit and for-profit investment. Both models have advantages and disadvantages and both can have a critical impact on how an enterprise is viewed in the marketplace (Hamaoui 2005).

The choice of for-profit or non-profit entity has become a popular topic among those who are interested in bringing together social mission and business practices. Entrepreneurs want to figure out the most advantageous legal structure for their social mission activities and philanthropists want to make sure they are not ignoring innovations in social change efforts (Gair 2005).

Non-profit social entrepreneurs generally have a difficulty in raising start-up or expansion capital and this has driven many social entrepreneurs away from the non-profit sector. However, a social entrepreneur’s capitalisation problem is not entirely solved by choosing to launch as a for-profit organisation. As an initial matter, for-profit social entrepreneurs generally cut themselves off from the sources that have traditionally funded socially beneficial activities such as private foundations and governments. Although those sources may be shrinking, they still represent a significant and necessary source of support for social ventures (Kelley 2009).

The final decision for many social entrepreneurs is complicated by the fact that there is no clear answer; on the one hand a part of their activities often sit squarely in the public domain, while on the other, their commercial activities would best be served by a more commercial format (Hamaoui 2005).

The Hybrid organisation has both a for-profit and a non-profit component. The for-profit entity allows an enterprise to facilitate investment, while the non-profit can facilitate grant capital and have no shareholders need for a return on their investment when providing services to a community (Kelley 2009). The Hybrid model is seen as a possible solution to the bringing together of social mission and business practices (Gair 2005).

Social Enterprises have a special role in emerging markets like South Africa. Emerging market Social Enterprises have their own distinctive characteristics, and in many cases, these Social Enterprises can provide a rich source of learning for others. There are an increasing number of Social Enterprises that are being launched in South Africa (Fury 2010). While many of these fail, there are some that have achieved great success and can provide the raw material from which the structural conditions of this important area of endeavour can be identified, analysed and improved (Fury 2010).

This study fills a gap in that there is currently no significant research identifying the challenges faced in moving to a Hybrid Social Enterprise business model and whether moving to the Hybrid model has had the desired impact. The move to a Hybrid business model is a costly one and one that Social Enterprises facing difficulty raising capital in the current climate are carefully considering (Legal Resource Centre 2011). Most of the previous research on Social Enterprise has tended to focus on the needs (Smallbone, Evans, Ekanem and Butters 2001, Hines 2005, and Haugh 2006) or challenges facing Social Enterprises (Islam 2007, Social Enterprise Coalition 2009). The Hybrid business model represents a potential solution to some of the challenges facing traditional Social Enterprises.

The study has two main beneficiaries. Firstly, by understanding the rationale, the challenges faced and the outcome of setting up a Hybrid Social Enterprise business model the research will enable current and aspirant social entrepreneurs to learn from social entrepreneurs who have previously gone down this path and enable them to make a more informed decision regarding the choice of business model to follow. Secondly, it is intended that that the evidence will inform the agencies that support Social Enterprises to enable them to better target their areas of support.

1.5 Delimitations of the study

- The study will only address South African Social Enterprises that do not have an international parent company so as to eliminate any bias from an international parent's management or financial influence.

1.6 Definition of terms

- Social Enterprise – A Social Enterprise is any business venture created for a social purpose to reduce a social problem or a market failure while using a financially sustainable business model with mechanisms for ensuring accountability to its beneficiaries (Alter 2006).

- Social Entrepreneur – Social entrepreneurs are often defined as people who can recognise a social problem and use business or entrepreneurial principals to create a solution. These are people who bring urgency, passion and a business-like approach to development and they can often find solutions to critical issues that have evaded governments and traditional non-profit organisations (Greater Good South Africa 2008).

- Social Economy - The social economy is a broad spectrum of activity which emerged as a third alternative to the private and public sector. The social economy is made up of community organisations working for the greater good of local communities and marginalised groups and consists of association-based economic initiatives such as co-operatives and non-profit organisations (Restakis 2006).

- NGO - A non-governmental organisation is any non-profit, voluntary citizens' group which is organised on a local, national or international level. NGO's perform a variety of service and humanitarian functions, bring citizen concerns to Governments, advocate and monitor policies and encourage political participation through provision of information. Some NGOs are organized around specific issues, such as human rights, environment or health. They provide analysis and expertise, serve as early warning mechanisms and help monitor and implement international agreements (Global NGO Community 2000)

- NPO – A non-profit organisation does not aim to make profits for their members. Their objective is providing public services to communities or society at large. These services include among others charitable work, education and promoting social welfare. Non-profit entities can generate their own income and make profits, but this profit is aimed at the promotion of the objectives of the entity as set out in the founding document. The profit cannot be distributed in the form of dividends to members or board members at the end of the financial year. These may include Voluntary associations, Trusts and Section 21 companies (Legal Resource Centre 2011).

- For-profit organisation - exist primarily to generate a profit. This financial return is at the disposal of the owners who can either keep it for themselves or reinvest it in the organisation. Investors are thus able to receive a financial return on their investment. For-profit organisations can take the form of a Cooperative, a Private company or a Close Corporation (Legal Resource Centre 2011).

1.7 Assumptions

The following assumptions have been made regarding the study:

1. The total number of respondents will be sufficient to gain adequate information.

2. Information will be conveyed honestly and truthfully by the respondents. False data may have a detrimental effect on the study's results.

2 LITERATURE REVIEW

2.1 Introduction

The prevalent view of entrepreneurship is about the creation of new for-profit ventures to achieve a particular commercial objective. However, if you harness the contribution of all entrepreneurial activity in an economy, then entrepreneurship should be pictured more broadly to capture all forms of enterprising activity. One of these forms is social entrepreneurship. The social entrepreneur is an individual who recognises, evaluates and exploits business opportunities that result in creating social value (Greater Good South Africa 2008, Shaw and Carter 2007). A distinguishing characteristic of social entrepreneurs is their ability to integrate a business model to the provision of a social need. The potential to serve a “double bottom line”, meaning the blending of financial and social returns simultaneously makes the social entrepreneur an important economic and social resource (Hynes 2009).

A Social Enterprise can be viewed as any business venture created for a social purpose to mitigate or reduce a social problem or a market failure and to generate social value while operating with the financial discipline, innovation and determination of a private sector business (Alter 2006).

In its widespread usage, "social entrepreneur" is the individual and "Social Enterprise" is the organisation. Therefore Social Enterprise can be viewed as the institutional expression of the term social entrepreneur (Alter 2006).

This review firstly looks at background and history of Social Enterprises and will seek a definition of Social Enterprise from the various existing definitions in the literature. The review then looks at the different organisational structures that a Social Enterprise can take. Thereafter, the review looks at the legal structures that currently exist in the developed economies of the United States and the United Kingdom and then compares them to the legal structures that exist in South Africa. The choice of for-profit or non-profit structure is then critically examined and finally the advantages and disadvantages of the hybrid organisation is presented.

2.2 Setting the context for Social Enterprises

2.2.1 *History*

Social Enterprise has a long private history, but a short public one. Non-profit organisations have engaged in income generation and businesses to either supplement or complement their mission activities for a long time (Alter 2006). In the United Kingdom (herein referred to as UK), cooperatives functioned as a means to fund socioeconomic agendas from as early as the mid-1800's. Starting in the 1960's, non-profits in the United States (herein referred to as US) experimented with enterprises to create jobs for disadvantaged populations. Micro-credit organisations started appearing in the 1970's which was about the same time Community Development Corporations (herein referred to as CDC's) gained popularity in the US. However, it is only in the last 20 years that the topic of non-profits adopting market-based approaches to achieve their missions has become popular with academics, practitioners, and donors (Alter 2006). The growing practice of Social Enterprise is fuelled by non-profit organisations' quest for sustainability, particular when support from traditional, philanthropic, and government sources have begun to decline and competition for available funds increasing (Alter 2006).

2.2.2 *A definition for Social Enterprise*

There is currently no widely accepted definition of a Social Enterprise (Kelley 2009). Grassl (2011) notes that a recent publication listed twenty different definitions, and one year later another compilation listed twenty seven. The confusion over a definition is aggravated by the use of different legal forms around the world, some being reserved for non-profit organisations (Grassl 2011). Confusion over the definition of Social Enterprise is found across the world as researchers attempt to come to terms with the growth of organisations that marry philanthropy and business models to build mixed organisational forms (Alter 2006). The lack of a widely accepted definition contributes to the difficulties of obtaining and generating statistical and other data about Social Enterprises (Lyon and Sepulveda 2009).

Grassl (2011) notes that terminological proliferation is the hallmark of every new field that grows rapidly. An example of this was when the study of marketing developed in the 1950's and 1960's. A similar conceptual confusion arose, which was eventually resolved through the success of the iconic Philip Kotler textbook "Marketing Management" which was first published in 1972 (Grassl 2011). Through this arose the worldwide expansion of consultants who were trained to spread the terminology and tools. Over time, different approaches that were supported by different schools banded together. This has happened to many disciplines within social science (Grassl 2011). In the case of social entrepreneurship, two facts exacerbate the situation, firstly it is managers and entrepreneurs and not researchers that determine the evolution of the field, with their constant evolution to find the best solution to social issues, and secondly that wide differences exist worldwide in socio-economic values and systems (Grassl 2011).

The definition currently used by the UK Government is, “A Social Enterprise is a business with primarily social objectives, whose surpluses are principally reinvested for that purpose in the business or in the community, rather than being driven by the need to maximise profits for shareholders” (Alter 2006). This definition was deliberately kept open to allow a wide range of organisations that define themselves as Social Enterprises to be included (Smallbone and Lyon 2005).

There is currently no existing South African policy on Social Enterprise, nor is there a legal definition. The definition adopted at a National Conference on enabling the environment for Social Enterprise development in South Africa, hosted by the International Labour Organisation (herein referred to as ILO) in October 2009 is, “A Social Enterprise’s primary objective is to address social problems through a financially sustainable business model where surpluses (if any) are mainly reinvested for that purpose” (Fury 2010).

This definition is not a universally agreed definition. The first two elements of the definition, which focuses on having a core social purpose and being financially sustainable are accepted, it is the point about whether to restrict the definition to include only those enterprises where, surpluses are mainly reinvested, that is unclear as this potentially excludes a number of for-profit enterprises which have at their core a social mission. Other issues which continue to be debated in South Africa are the interpretation of intent with regards to the primary objective of a business and how to measure social impact (Fury 2010).

Where there is some consensus, it is that there should be three elements which make up the working definition for Social Enterprise in South Africa (Fury 2010). These are that a Social Enterprise:

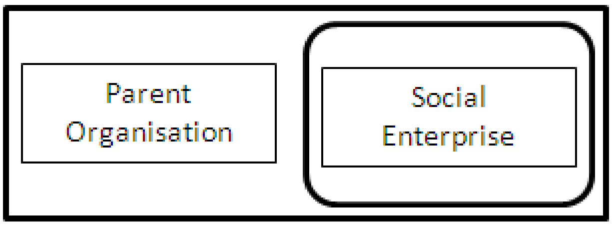
a) has a primary social purpose which means it has a clearly stated social purpose as its core objective;
b) uses a financially sustainable business model , meaning that it has a realistic prospect of generating sufficient income to exceed costs, now, or at some point in the future; and,
c) is accountable and transparent and has a mechanism for ensuring accountability to its beneficiaries.

For the purposes of this research report, because the research is based on South African Social Enterprises, this definition will be used.

2.3 Organisational Structure

Shaw and Carter (2007) classified Social Enterprises into three business forms, namely not for-profit, for-profit and a Hybrid form where the firm operates to create employment and generate revenue which is mainly reinvested back into the business. These business structures may be independently owned operations or may be a public private partnership (Hynes 2009). A Social Enterprise can be structured as a department, program or profit-centre within a non-profit organisation and lack legal definition from its parent organisation. A Social Enterprise may also be a subsidiary of its non-profit parent, registered either as a for-profit or non-profit. Some organisations use a mix of different structures simultaneously (Alter 2006).

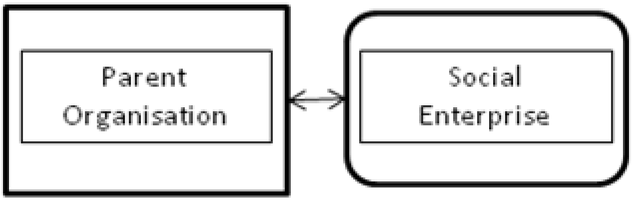
Figure 1: Social Enterprise structured internally



Source: (Alter 2006)

The Social Enterprise is structured as a department or profit centre within the parent organisation. The Social Enterprise does not have to share a space with the parent. From a legal, financial management or governance perspective, the Social Enterprise is internal to the non-profit parent. Systems, back office, staff and management are integrated into the parent (Alter 2006).

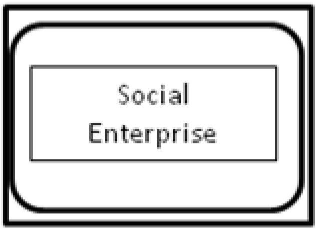
Figure 2: Social Enterprise structured as a separate entity



Source: (Alter 2006)

The Social Enterprise is structured as a separate legal entity, either a for-profit or a non-profit. The Social Enterprise does not have to physically share a space with its parent organisation. From a legal, financial management or governance perspective, the Social Enterprise is external to the non-profit parent. Staff, overheads and back office are normally shared on a contractual basis as a business relationship (Alter 2006).

Figure 3: Social Enterprise structures as the same entity



Source: (Alter 2006)

The Social Enterprise is the same entity as the parent organisation. This means that functionally, the Social Enterprise is the only activity of the organisation. This type of Social Enterprise may evolve into one of the other structures by adding new enterprises or social programs. This is the most common form of Social Enterprise (Alter 2006).

The challenge for the social entrepreneur is how to align their Social Enterprise format to address and satisfy the changing needs of their stakeholders whilst maintaining a revenue stream to sustain the enterprise (Hynes 2009).

2.4 Legal Structures

The law in many countries do not make provision or recognise Social Enterprises as legitimate or legal. Therefore, non-profit organisations risk losing their non-profit status and associated privileges by launching a Social Enterprise or income-generating activity. Some countries have made special provisions in the law and tax codes for Social Enterprises (Alter 2006).

2.4.1 *The United States*

In the US, Social Enterprises can take various legal forms, including sole proprietorship, corporation, partnerships, limited liability companies, and non-profit and for-profit organisations. However, no new legal frameworks have been introduced in the last 50 years to regulate the growing business activities of service-producing non-profit organisations (Galera and Borzaga 2009).

In the US, a few states have adopted a low profit, limited liability company status (or L3C), which is unique because it lets companies facilitate investments while simplifying compliance with IRS rules for program related investments. It addresses the issue of funding, but does not address mission anchor, transparency or governance issues, all of which become serious friction points in the context of mixing mission and money (Clinton 2009). There's also the B Corp organisation, which has no legal ramifications as yet but serves as a “trustmark” and signifies social responsibility to customers (Kelley 2009), however it too does not address any of the other issues (Clinton 2009).

2.4.2 *Europe*

In Europe the policy and legal context appears to be more conducive to the development of Social Enterprises (Galera and Borzaga 2009). Two phases can be identified in Europe as far as the legal evolution of Social Enterprises is concerned. Initially, most Social Enterprises were set up through the use of the legal forms of cooperative and association. Social Enterprises were initially established as associations in those countries where the legal form of association allows for a degree of freedom in selling goods and services on the open market, such as for instance France and Belgium. In countries where associations are more limited in this regard, such as the Nordic countries and Italy, Social Enterprises were more often created under the legal form of cooperative (Galera and Borzaga 2009).

In the UK, the legal system is catching up with the need for Social Enterprises and they have developed the Community Interest Companies (herein referred to as CIC). CIC's are companies, with special additional features, created for the use of people who want to conduct a business or other activity for community benefit and not purely for private gain. This is achieved by a "community interest test" and "asset lock", which ensures that the CIC is established for community purposes and that the assets and profits are dedicated to these purposes. Registration of a company as a CIC has to be approved by the UK Regulator who also has a continuing monitoring and enforcement role (Kelley 2009). The CIC association reports that there are now more than 3500 registered in the UK (Clinton 2009).

2.4.3 *South Africa*

There is currently no existing South African policy on Social Enterprise, nor is there a legal definition unlike in the case with business entrepreneurs or non-profit structures in South Africa (Fury 2010).

The South African company legislation has received a major overhaul with the new Companies Act 71 of 2008 coming into effect in 2011, which has impacted dramatically on the manner in which companies in South Africa operate and are managed. The new Companies Act introduces a revised legal entity and classification for non-profit entities which effectively replaced the Section 21 Company but not Trusts and Voluntary Associations. The old Companies Act made provision for public and private companies with share capital, companies without share capital such as Section 21 Companies, and external companies. A Section 21 Company was previously classified as a Public Company and thus all regulations that applied to Public Companies applied to Section 21 Companies (Legal Resource Centre 2011).

The new Companies Act classifies a Non-Profit Company and Profit Company, which includes State-Owned Companies, Private Companies, Personal Liability Companies and Public Companies. The new Companies Act has effectively replaced the Section 21

Company with the Non-Profit Company. The Non-Profit Company (herein referred to as NPC) now has a legal nature of its own that is distinct from both the public and the private company, and to a large extent is treated uniquely and is no longer burdened by the rules and regulations that apply to public companies (Legal Resource Centre 2011).

The NPC can generate their own income and make profits, but this profit is aimed at the promotion of the objectives the entity has set out in the founding document. An NPC has legal personality separate from its members and directors meaning that the NPC can sue and be sued in its own name, and can own property. An NPC does not have shares therefore its members are not called shareholders. A NPC is prohibited from distributing its profits by way of dividends to its members (Legal Resource Centre 2011).

In a for-profit Company, the financial return is at the disposal of the owners who can keep it for themselves or reinvest it in the organisation. Investors are therefore able to receive a financial return on their investment. A for-profit entity which can demonstrate its earning potential should be able to access finance by taking on debt. This is no different to a non-profit, however lenders are likely to lend to a for-profit entity (Legal Resource Centre 2011). For-profits can also issue equity (shares), which can allow them to raise large amounts of money in return for ceding some control of the business and rewarding investors with dividends when profits are made (Legal Resource Centre 2011).

Currently in South Africa, a Social Enterprise can take the form of a non-profit or a for-profit entity (Legal Resource Centre 2011).

2.5 Non-profits vs For-profit

The choice of for-profit or non-profit entity has become a popular topic among those who are interested in bringing together social mission and business practices. Entrepreneurs want to figure out the most advantageous legal structure for their social mission activities and philanthropists want to make sure they are not ignoring innovations in social change efforts (Gair 2005).

A for-profit structure brings profit pressures while a non-profit structure brings social mission pressures. Sometimes these pressures can co-exist productively but often they pull an organisation in different directions. Taking note of these conflicting pressures does not preclude holding for-profit corporations responsible for good corporate behaviour, nor does it prevent non-profit organisations from engaging in commercial activity. It does suggest that there are limits to how much and what we can expect from either a for-profit or a non-profit structure (Gair 2005). Some of the issues that have been raised in the literature are listed below.

2.5.1 *Advantages of a non-profit legal structure*

A non-profit legal structure provides some assurance to a social mission-focus which includes the promise to reinvest any excess assets back into the organisation's social mission work rather than distributing them to individuals. In addition, the commercial activities of a Social Enterprise, while useful in furthering a social mission, also introduce economic pressures that can pull an organisation away from social mission activity. The non- profit legal structure can act as a reminder of the larger mission, and provide a check on the propensity to drive toward business success at the expense of social mission (Gair 2005).

Non-profits have access to grants and donations that are not available to for-profits, including Socio- Economic Development funding through Broad-Based Black Economic Empowerment (BBBEE), and funding from government departments that will only provide funds to registered NPC's (Legal Resource Centre (2011). In addition, non-profits receive tax exemption for the entity's income and for donations to the entity which can be big advantage when competing with for-profit organisations (Legal Resource Centre 2011).

There is also the issue of public image. NPC's, where private benefit is restricted, are more attractive to customers as well as donors, and in effect represents a marketing competitive advantage in some situations (Legal Resource Centre 2011).

2.5.2 *Disadvantages of a non-profit legal structure*

Non-profits face the possibility of external funders stipulating how their funds can be spent. Such restrictions on the nature and scope of activities can limit an organisation's autonomy in deciding how to best to meet client needs. In turn, the organisation's opportunity for self-sufficiency and sustainability is constrained (Diochon and Anderson 2009, Austin, Stevenson and Wei-Skillern 2006). Few non-profits would deny that the prospect of financial support from governments and other institutions such as the World Bank is alluring and thus their strategic agendas are known to be driven and shaped by the priorities of funders (Diochon and Anderson 2009). In contrast, when funding is largely self-generated, an organisation has much greater flexibility and freedom of choice, not to mention the contribution such funding makes to financial self-sufficiency (Mair and Marti 2006).

In a recent study of the emerging fourth sector, social entrepreneurs reported that their most pressing challenge was gaining access to investment capital. The main reason for this struggle is because organisations with multiple bottom-line goals do not fit the settled categories and the expectations of existing sources of capital (Kelley 2009).

Many social entrepreneurs find that the non-profit legal form is not well suited. One problem is that tax-exempt non-profits exist to benefit the public, which means that all profits must be ploughed back into serving the organisations' charitable missions. Because a non-profit cannot issue stock or otherwise distribute profits to owners there is no straightforward way for a venture capitalist or other for-profit investor to take an equity stake in a non-profit social venture. Non-profits may, like other organisations rely on traditional debt, but debt instruments tend to be more expensive and less flexible than equity. Furthermore, traditional lenders such as banks are hesitant to make loans to non-profits on competitive terms because they are aware that a non-profits' ability to repay the debt is constrained by the lack of access to other sources of capital (Kelley 2009).

2.5.3 *Advantages of a for-profit legal structure*

The main reasons for choosing a for-profit structure relate to access to capital. Undercapitalisation is a problem in most Social Enterprises, particularly for capital intensive enterprises such as manufacturing. For-profits have the ability to raise equity investments that, depending on the local laws, are not an option for non-profit entities, whose assets are considered publicly owned. An example of this is that a for-profit has access to enterprise development funding in South Africa (Legal Resource Centre 2011).

Ridley-Duff (2009) suggests that equity in any form can help businesses develop faster because it encourages a creative attitude towards efficiencies as well as new options for collaborations and partnerships. Some Social Enterprises opt to incorporate as a for-profit and many mature non-profits convert their legal status in order to capitalise the business with private funds in exchange for equity (Ridley-Duff 2009).

In addition, a for-profit entity has flexibility regarding the distribution of profits and payments can be made to owners and investors in the form of dividends as well as having the ability to re-invest back into the entity for the social purpose. A for-profit entity will also find it easier to access some forms of debt that non-profits would find hard to get (Legal Resource Centre 2011).

From an internal viewpoint employees are a key resource and enabler in the successful achievement of the vision of the social entrepreneur. Retaining staff in a non-profit may not always be an easy task as the lack of financial resources, inability to guarantee job security or provide attractive salaries renders it a challenge for the social entrepreneur. These issues are somewhat solved in a for-profit legal where the company may offer important employees higher salaries and share options (Hynes 2009).

2.5.4 *Disadvantages of a for-profit legal structure*

For-profit Social Enterprises have shareholders who require a return to their invested capital. Unlike non-profit enterprises who primarily have social objectives and whose surpluses are reinvested in the business or in the community, for-profit Social Enterprises will therefore be driven by the need to maximise profit for shareholders and managers (Hamaoui 2005). The need to maximise return to shareholders can lead to loss of mission focus towards the social cause and can create tension within the company (Hamaoui 2005). Another reason that choosing to form as a for-profit entity will not solve a social entrepreneurs capitalisation issues is that the practices and the expectations of the normal sources of for-profit capital, venture capitalists and institutional investors such as pension funds, typically expect market rates of return which a multi bottom-line organisation is rarely in a position to offer (Kelley 2009).

An example of this can be seen in the case study of Community Products, Inc. 27 (CPI). Ben & Jerry's (a famous Social Enterprise) cofounder Ben Cohen started this for-profit company CPI that manufactured chocolate products using nuts whose collection helped preserve many rainforest areas. The company also donated a percentage of its profits to other organisations supporting social causes. The company had early successes on both business and social mission fronts, but this was quickly followed by many challenges. One of these was conflict between mission and the need to be profitable. The company found that it wasn't always profitable to source the nuts from the rainforest-positive farms because the quality was uneven. Although in order to maintain its social mission objectives, CPI needed to continue purchasing from these approved vendors. Throughout the company's downturn, the conflict between its stated social mission goals and the underlying financial structure and needs created a wedge which made survival as either a viable profit-generator or a social mission implementer impossible (Gair 2004).

Social entrepreneurs' difficulty in raising start-up or expansion capital has driven many to the for-profit sector, however capitalisation problems are not entirely solved by choosing to launch as for-profit venture. For-profit social entrepreneurs generally cut themselves off from the sources that traditionally have funded socially beneficial activities such as private foundations and governments. These sources of funding represent a significant and necessary source of support for social ventures (Gair 2004).

Another reason why a Social entrepreneur would be hesitant to use a for-profit entity is that while for-profits create a public image of being efficient and business- like, which may attract customers in some situations, there is a large negative stigma attached to for-profits operating in the social sector which can mean that even if the for-profit is doing the right thing, they can be attacked for having ulterior motives (Hamaoui 2005).

2.6 Best of both worlds

As social entrepreneurs view the landscape of potential funding available to them they inevitably begin to assess their options and opportunities for both non-profit and for-profit investment. Both models have advantages and disadvantages and both can have a critical impact on how an enterprise is viewed in the marketplace (Hamaoui 2005).

The final decision for many social entrepreneurs is complicated by the fact that there is no clear answer; on the one hand a part of their activities often sit squarely in the public domain, while on the other, their commercial activities would best be served by a more commercial format (Hamaoui 2005).

The US and UK are at the cutting edge of the blended value business space in trying to create legal structures that meets the needs of an entity that exists to provide social good and yet makes a profit, however these legal structures, while still in their infancy, have not been overly successful (Hamaoui 2005) and may even create niche and boutique change agencies that may relegate Social Enterprise to a special corner of the business world where only the overly idealistic entrepreneurs go (Clinton 2009). Most countries have to work with what they've got, and as a result, more and more social entrepreneurs are choosing to launch both a non-profit and a for-profit to get the best of both models (Kelley 2009).

2.7 Hybrid Social Enterprises

In this research report, I am using the term “Hybrid organisation” to represent formal organisations, networks or umbrella groups that have both a for-profit and a non-profit component. This could occur as a result of a for-profit organisation creating a non-profit affiliate or if a non-profit organisation establishes a for-profit subsidiary or affiliate. The for-profit entity allows an enterprise to facilitate investment, while the non-profit can facilitate grant capital and have no need to make a margin in providing services to a community (Kelley 2009).

Examples of the former are two prominent community development financial institutions, the Grameen Bank in Bangladesh and Shorebank Corporation in Chicago, which were set up as for-profit organisations but over time created non-profit affiliates and for-profit subsidiaries to attract and deploy resources more efficiently (Dees and Anderson 2003). Examples of the latter are non-profit organisations such as the Girl Scouts and United Way which established for-profit subsidiaries to generate revenues for their programs by selling equipment and merchandise to local organisations as well as the licensing of the organisations name and logos to vendors (Dees and Anderson 2003).

An issue with doing this may be tax laws, as non-profits enjoy tax exemption. Hybrid organisations are watched very closely by tax authorities because any non-profit organisation as a part of or as a subsidiary corporation to any for-profit company or venture can lose its non-profit status depending upon the flow of resources and the focus of who is the actual beneficiary of any initiative or funding. For the Hybrid structure to work, the mission of each organisation, its organisational structure, and its funding sources must be clearly delineated, separate, and there must be full disclosure of all involvements which may be considered cross-pollinated (Klopp 2007).

There could also be challenges relating to branding of the organisation, positioning to potential investors and donors, competing work cultures within the two organisations as well as transparency issues (Kelley 2009).

2.8 Research Questions

This legal structure question is not an easy one, but it is clear that the choice does matter. It is part of an organisation’s message to the world about who they are, it imposes specific requirements that differ fundamentally depending on which structure is chosen, and the choice affects an organisation’s path into the future (Gair 2005). One of the solutions to this issue is forming a Hybrid organisation which at first glance seems to incorporate the best of both worlds, but may also pose its own problems (Kelley 2009).

The research looks to answer the following questions:

2.8.1 *Research Question 1*

1. What is the rationale for a Social Enterprise to create a Hybrid model?

2.8.2 *Research Question 2*

2. What are the challenges that a Social Enterprise is faced with when creating and maintaining a Hybrid business model?

2.8.3 *Research Question 3*

3. What impact does moving to the Hybrid business model have on a Social Enterprise?

By answering these three research questions, the research aims to bring clarity to the discussion and help thousands of non-profit and for-profit social entrepreneurs in South Africa who may be considering changing to a Hybrid business model avoid costly mistakes.

3 RESEARCH METHODOLOGY

This section describes the methodology that will be followed to conduct the research. Firstly, the literature around the selected research approach will be discussed, and will this be followed by a review of the research design and the research the instrument. Thereafter data collection and analysis issues will be addressed, and finally the chapter concludes by focussing on issues relating to validity and reliability.

3.1 Research methodology

The study of Social entrepreneurship and especially the phenomena of Hybrid Social Enterprises are still at an exploratory stage and thus the method chosen to perform this research is a qualitative research method.

Qualitative research differs from quantitative research in that the data collected is analysed using open-ended questions or words rather than closed-ended questions or numbers. It is a means of exploring and understanding the meaning individuals or groups attribute to a social or human problem (Creswell 2009).

An advantage of open-ended questions in exploratory research is that it gives participants the opportunity to respond in their own words, rather than forcing them to choose from fixed responses, as quantitative methods do. Another advantage of qualitative methodology is that it allows the researcher the flexibility to probe the participant's initial response by asking why or how (Creswell 2007).

Patton (1990) refers to three types of data collection within the qualitative method:

1. In-depth, open-ended interviews: these consist of direct quotations from people about their experiences, opinions feelings and knowledge;
2. Direct observation: these are detailed descriptions of peoples' activities, behaviours actions and the complete range of interpersonal interactions and organisational processes that are part of a observable human experience;
3. Written documents: these are excerpts, quotations or entire passages from organisational, clinical, program records, memoranda, correspondence, official publications, reports, personal diaries or open-ended written responses to questionnaires and surveys.

The above elements of a qualitative research study enable the research of specific issues in an in-depth and detailed manner. The research is not constrained by predetermined analysis as with quantitative analysis, but rather is open-ended in nature and enables the study to take a somewhat evolutionary course of discovery (Patton 1990). Due to the exploratory questions being asked in the research regarding a non-profit Social Enterprise moving to a Hybrid business model, a qualitative approach is best suited for the study.

The data will be collected in a series of in-depth interviews with each respondent, and the budgeted time for each of these interviews is 60-90 minutes. The in-depth interviewing technique involves conducting intensive individual interviews with a small number of respondents to explore their perspectives on a particular idea, program, or situation (Boyce and Neale 2006).

In-depth interviews are useful in extracting detailed information about a person's thoughts and behaviours or to explore new issues in depth. The interviews are often used to provide context to other data (such as outcome data), and offers a more complete picture of what happened and why (Boyce and Neale 2006).

Although open-ended questions will be used, the interviews will be semi-structured to ensure that relevant information is obtained (Creswell 2007). The research will assume that respondents will be honest and candid in their answers.

3.2 Research Design

The research design will be in the form of phenomenological research. Phenomenological research is a strategy of inquiry where the researcher identifies the essence of human experiences about a particular phenomenon as described by the participants (Creswell 2009).

The phenomenological approach is based on a paradigm of personal knowledge and subjectivity, and therefore it emphasises the importance of personal perspective and interpretation. For that reason, the approach is a powerful way of understanding subjective experience, gaining insights into people's motivations and actions, as well as cutting through the clutter of "taken for granted" assumptions and conventional wisdom (Lester 1999).

This approach seems to be the logical method for answering the questions posed in the research which relate to rationale, the challenges and the outcome of a non-profit Social Enterprise moving to a Hybrid business model.

3.3 Population and sample

3.3.1 *Population*

The population will be Social Enterprises that have opened at least one for-profit subsidiary and for-profit Social Enterprises that have opened at least one non-profit subsidiary which would mean that they would have moved to a Hybrid Social Enterprise business model. Five companies that met this profile and agreed to the interviews are listed below.

Table 1: List of Hybrid Social Enterprises

No.	Social Enterprise	Location	Website
1	Johannesburg Housing Company (Pty) Ltd	Joahnnesburg	www.jhc.co.za
2	Dreamhouse Workshop for the Blind	Pretoria	www.dreamhousedesigns.co.za
3	Shonaquip (Pty) Ltd	Cape Town	www.shonaquip.co.za
4	Stitch Wise (Pty) Ltd	Carletonville	www.stitchwise.co.za
5	The Brocolli Project (Pty) Ltd	Cape Town	www.broccoliproject.org

3.3.2 *Sample and sampling method*

The founding members or the head of operations of each of the Social Enterprises were selected from each company due to their knowledge of the events prior and the impact after the move to a Hybrid Social Enterprise business model. Interviews were requested by email (see appendix A for respondent letter) with a follow up phone call. If these individuals are unavailable in the interview period, an alternate respondent who would be able to answer the questions was requested. By their very nature, Social Enterprises which are focused on doing good and the social entrepreneurs who run these organisations wanted to share their experiences. Appendix B gives a summary of the individuals selected.

3.4 The research instrument

The semi-structured interview questionnaire is provided in Appendix C. The questions that were raised in the research are exploratory in nature. Semi-structured interviews are more flexible than standardised methods such as the structured interview or survey. This approach not only allows the interviewer to have some established general topics for investigation it allows for the exploration of emergent themes and ideas rather than relying only on concepts and questions defined in advance of the interview (Creswell 2007). The questions will be asked in a similar order and format to make amongst all the correspondents to be able to form comparisons between answers possible however, the interviewer will probe for novel and relevant information through additional questions and prompts.

3.5 Procedure for data collection

The interviews were pre-arranged with the selected interviewees, for each of the selected Hybrid Social Enterprises. Prior to the interviews, financial statements were requested as well as a social reach measure prior and post to the move to a Hybrid business model which was used to supplement the interviews data. Interviews in Johannesburg took place in their respective head offices. Interviews with respondents in Cape Town took place telephonically. All interviews were recorded and hand-written notes were also taken. The interviews were then transcribed to enable efficient analysis of data.

3.6 Data analysis and interpretation

Miles and Huberman (1994) state that qualitative data analysis should consist of three concurrent activities: data reduction, data display, and conclusion drawing/verification. This is the approach that this study will take. During the data reduction phase, the transcripts from the recorded interviews were made into summaries for analysis.

The summarised data was then used to develop categories of phenomena by means of a coding system. This enabled the efficient management of the data in terms of labelling, storing, and retrieving according to the codes. Patterns and processes, commonalties and differences were then isolated and were filed for the next stage of data analysis. Themes were then be extracted from the coded data which were gradually reduced to a small set of generalisations that cover the consistencies discerned in the data base. Conclusions were drawn from these generalisations.

3.7 Limitations of the study

The study is dependent upon the availability of a small number of individuals who have been key decision makers in moving their Social Enterprise into a Hybrid model. At this stage there are very few Social Enterprises that have gone through the process because the outcomes are not widely known. Thus generalisations from the findings are somewhat limited.

3.8 Validity and reliability

3.8.1 *External validity*

External validity relates to "generalising" and is the degree to which the conclusions in your study would hold for other persons in other places and at other times (Trochim 2006).

The qualitative research methodology produces a lot of detailed information about a small number of specific cases or issues and thus cannot be generalised to the extent of quantitative data (Patton 1990). This difficulty with generalisability was considered and because of the small population of non-profit social Enterprises that have moved to a Hybrid business model, the number of companies that have been selected to participate in the research suggests a representative sample of the population. The study will also be conducted in a variety of places, with different people and with social Enterprises that moved to a Hybrid business model at different periods in time which should improve the external validity.

3.8.2 *Internal validity*

Internal validity relates to the inferences regarding cause-effect or causal relationships in a study. Internal validity is therefore only relevant in studies that try to establish a causal relationship (Trochim 2006). This study will ensure internal validity by replicating the interview structure with each interview. In addition, there will be triangulation with financial statements and measures of reach which will further support the internal validity of the study.

3.8.3 *Reliability*

Reliability is the extent to which results are consistent over time and if they are an accurate representation of the total population under study. If the results of a study can be reproduced under a similar methodology, then the research instrument is considered to be reliable (Golafshani 2003).

Reliability in the study was assured by choosing an accurate research instrument that was tested on a trail respondent prior to the actual interviews of the Hybrid Social Enterprise respondents. The instrument was then refined and clarifications made so as to ensure that the appropriate data was obtained from the respondents.

3.9 Consistency matrix

Table 2: Consistency matrix

Understanding the rationale, the process, and the result of a non-profit Social Enterprise creating a for-profit subsidiary					
Sub-problem	**Literature Review**	**Research questions**	**Source of data**	**Type of data**	**Analysis**
What were the reasons that made non-profit Social Enterprise establish a Hybrid Business model	Alter (2006) Hynes (2009) Kelley (2009)	Understand the rationale for a non-profit Social Enterprise to create a for-profit subsidiary	Respondents in semi-structured interviews Company documents (financial statements and reach measures)	Qualitative	1) Data Reduction, 2) Data Display, 3) Conclusion Drawing (Miles and Huberman 1994)
What were the challenges that non-profit Social Enterprise experienced during and post the conversion to the Hybrid business	Alter (2006) Clinton (2009) Galera and Borzaga (2009) Kelley (2009) Fury (2010)	Understand what the challenges that non-profit Social Enterprises looking to move into a Hybrid business model should aware of	Respondents in semi-structured interviews	Qualitative	4) Data Reduction, 5) Data Display, 6) Conclusion Drawing (Miles and Huberman 1994)
Did the move to a Hybrid business model have the impact that was intended	Gair (2005) Hamaoui (2005) Kelley (2009) Legal Resource Centre (2011) Ridley-Duff (2009)	Understand whether a non-profit Social Enterprise creating a for-profit subsidiary has the desired impact	Respondents in semi-structured interviews Company documents (financial statements and reach measures)	Qualitative	7) Data Reduction, 8) Data Display, 9) Conclusion Drawing (Miles and Huberman 1994)

4 BACKGROUND ON THE SELECTED SOCIAL ENTERPRISES

This section contains a profile and some background of the selected Hybrid Social Enterprises that were interviewed. Information was drawn from interviews, the organisations websites and data accessed from ASEN Network which is a database of Social Enterprises.

4.1 The Johannesburg Housing Company (JHC)

4.1.1 *Overview*

Head Office: Johannesburg

Geographic Footprint: Gauteng

Annual Turnover: R103 million

4.1.2 *Background*

JHC was formally launched in 1995. The Social Enterprise was created in response to the need for affordable accommodation for people with low incomes. Since inception, JHC has developed more than 3 200 rental housing units and today provides homes to more than 9 500 people in low to middle income communities. The company has built up a portfolio of 27 buildings across Johannesburg's inner city and recently started focusing on the greater Johannesburg area in response to the continuing demand for housing from a fast growing urban population (ASEN1 2011).

JHC looks to turn houses into homes, to create neighbourhoods where people can come and go to work easily, where children can go to school, and where they can play safely. Along this developmental path, the company has taken on slum clean-ups, building upgrades, conversions and refurbishments, as well as new developments (ASEN1 2011).

The organisation provides low cost housing to approximately 9000 people in 3322 units across 27 buildings in the inner city of Johannesburg and the company has received national and international recognition for its pioneering work in the social housing sector (ASEN1 2011).

4.1.3 *Social Purpose*

The main purpose of JHC is to provide low cost housing for the lower end segment of Johannesburg. Johannesburg is strained by a burgeoning population which puts a premium on property, and consequently people with lower incomes are unable to secure affordable accommodation.

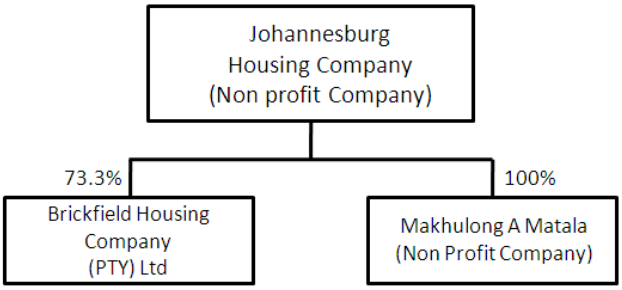
However, only 30 to 40% of tenants of JHC are from that income bracket. The remaining tenants have middle class backgrounds. This mix was a conscious choice as the organisation did not want to create “pockets of poverty” where poor people were all housed in a specific area or building. In addition, the organisation also found that this income group also had other needs, such as after care for children, educational workshops on other social issues and greater awareness of the relationship and expectations between tenants and the landlord. To implement these activities, JHC created a non-profit organisation called Makhulong A Matala (ASEN1 2011).

JHC also recognised the importance of building social cohesion in these areas. To this end, the organisation created the eKhaya Neighbourhood programme in conjunction with other neighbouring landlords. The eKhaya programme operates within a particular area and organises security and cleaning services for the community. It also hosts several activities, such as community festivals, youth days and other community events. Besides the social advantages, JHC believes that this adds commercial value to its properties (ASEN1 2011).

JHC has also created joint partnerships with the private sector to allow private sector participation in social housing projects. These partnerships have been very successful and have added more than seven hundred new housing units in the inner city.

4.1.4 *Business Form*

Figure 4: JHC Business Structure



Source: ASEN1 2011

The Johannesburg Housing Company is registered as a Section 21 non-profit company due to the need for donor funding to support the purchase of the initial low cost buildings. This structure also allowed the organisation to access government subsidies and grants. The subsidiary organisations consist of both for-profit and non-profit companies:

Makhulong A Matala (hereafter referred to as Makhulong) is a registered Section 21 non-profit company and its primary source of income is grant funding. Makhulong provides early childhood development centres, sports programmes, tenant support services and neighbourhood development programmes that focus on developing strong social communities around the JHC buildings (ASEN1 2011).

Brickfields Housing Company (hereafter referred to as Brickfields) is structured as a private company. Brickfields is a joint venture with the private sector, the primary aim being to demonstrate to the private sector that social mission can be coupled with commercial principles and profit. JHC owns 73.32% of the shares in Brickfields; the remaining shares are owned by equity investors.

4.1.5 *Products and Services*

The JHC is a social housing company. It provides affordable rental apartment accommodation in the inner city of Johannesburg to people in the lower income groups. The organisation also offers complementary social services to its tenants, for the purpose of raising the value and increasing the competitive advantage of their properties, as well as, to uplift their clients socially.

4.1.6 *Target Market*

The prospective tenants of the JHC's apartment units are young, primarily black, males or females living within the city limits. The organisation does not target the unemployed so as to ensure that tenants are able to pay their rent. Tenants are selected according to a set of pre-determined criteria and are usually close to the bottom of the earning scale (most earn between R2500 and R7000 per month).

4.1.7 *Financial Model*

JHC is committed to being a non-profit company that does not make a loss. The primary source of income of the organisation is rental fees and the largest expense is the salaries. The organisation works on a cross-subsidisation model in which the middle class tenants are charged more to allow for lower rental costs for tenants with lower incomes. The organisation reached breakeven point in 2003, and despite being rated as cheaper in property rental surveys, the organisation has been making substantial surpluses.

Makhulong receives money from JHC for its operational costs, and raises the rest of its income from grants and donations. It also receives interest from an endowment fund. Brickfields which is funded by equity and commercial funders currently receives its income through receipt of rent.

4.2 Stitch Wise

4.2.1 *Overview*

Head Office: Carletonville, Gauteng

Geographic Footprint: Gauteng and North West province

Annual Turnover: R25 million

4.2.2 *Background*

Natalie Killassy the founder and current CEO grew up in a mining town and was well aware of the hardships suffered by miners, especially those who have disabilities through mining accidents. She understood the daily difficulties they faced especially with regard to finding new employment. It seemed natural then for her to create a business that focused on safety for miners. In 1997, she registered Stitch Wise, a private company that employs paraplegics injured on the mines to create innovative products that dramatically enhance safety in the mines (ASEN2 2011).

The firm employs 128 workers, 50% of whom are disabled. Stitch Wise is widely recognised as a leader in the mining safety sector, and both Natalie and the organisation have received many awards, the latest being Schwab Foundation Award for Social Entrepreneurship and the Veuve Cliquot Ponsardin Award for Economic development in Africa (ASEN2 2011).

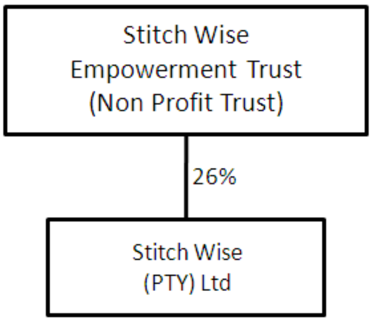
4.2.3 *Social Purpose*

Stitch Wise two main aims are to create employment and find solutions that minimise mining accidents. In mining communities, people with disabilities have very few employment options and survive on small grants from the mines once they are no longer able to work there. Most have little education and can become marginalised in their communities. In order to deliver a holistic response to these problems, Stitch Wise develops safety products for mines, develops personal protective equipment for miners, employs people with disabilities, and trains people with disabilities and other unemployed people to start small enterprises (ASEN2 2011).

Stitch Wise has two main products which are industry leaders in their categories. The first is a support structure for mine ceilings created from the residue of dust, sand and stone after mine drilling. The product has captured more than 50% of the market. The second is also an innovation in underground support systems, which uses steel reinforcement in some of the bags which increases the load capabilities beyond most other support systems. The placement of the steel is calculated scientifically and Stitch Wise has written a white paper on this new support system (ASEN2 2011).

4.2.4 *Business Form*

Figure 5: Stitch Wise Business Structure



Source: ASEN2 2011

Stitch Wise is structured as a private company with 26% of its shares held by the Stitch Wise Empowerment Trust, a registered non-profit trust. The dividends become venture capital for setting up new businesses in the community. Shares are divided among the founders (54%), other directors (20%), and the Trust (26%).

4.2.5 *Products and Services*

Stitch Wise's mindset is to identify opportunities to design unique, user friendly mining products which enhance safety, save on costs and improving productivity. These include personal protective equipment for miners and backfill support bags which form the pillars that prevent the mine ceiling from collapsing (ASEN2 2011).

The company also employs people with disabilities as well as helps unemployed people and people with disabilities in mining communities to start small enterprises. It does this by identifying needs in the community and assessing the potential for enterprise development. It then works closely with the potential entrepreneur through the development of the enterprise (ASEN2 2011).

A different product developed by the organisation is a non-incentive based food voucher which people can to give to beggars and other poor people. This is more productive than just donating money as the voucher can be exchanged at major retailers for basic food staples such as bread, milk, maize meal or vegetables.

4.2.6 *Target Market*

Stitch Wise's clients are mining companies and include some of the major companies in the industry like Gold Fields and Anglogold Ashanti.

4.2.7 *Financial Model*

Stitch Wise earns its income from the sale of its products. Despite the recent recession, Stitch Wise has consistently shown a profit. The organisation has only paid dividends to the Trust. Profits are shared with workers based on their performance and duration of employment. The remaining surplus is used to grow the business (ASEN2 2011).

4.3 Shonaquip

4.3.1 *Overview*

Head Office: Cape Town

Geographic Footprint: National and SADC Region

Annual Turnover: R24 million

4.3.2 *Background*

Shona McDonald's daughter was born with cerebral palsy in 1981 which brought to Shona's attention that wheelchairs available in South Africa were not suitable for children with this type of disability. Finding solutions for her own daughter led Shona to research the needs of people with disabilities in disadvantaged communities (ASEN3 2011).

Shona found that standard folding wheelchairs were inappropriate for the rough terrain found in South African rural communities and they did not provide any seating support to assist those who were unable to sit upright without help. Shona then designed a wheelchair based on her knowledge of her daughter's needs and soon started applying this knowledge for others in the same situation. In 1992, she registered Shonaquip a Close Corporation, which has since grown into one of the most respected suppliers of tailor-made wheelchair and posture support devices in the country (ASEN3 2011).

4.3.3 *Social Purpose*

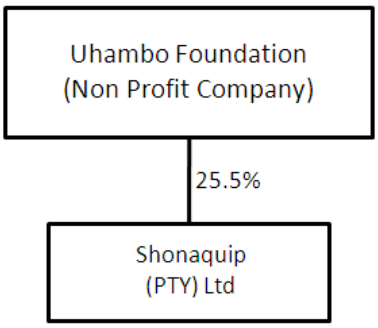
Shonaquip's aim is to help people with mobility disabilities realise their potential. This is done through a holistic strategy which includes making a wide range of therapeutic support and seating options available to the public by designing, manufacturing and selling these wheelchairs and other assistive devices. The organisation also provides intensive training for wheelchair users, their parents, caregivers, community workers and rehabilitation professionals, to enhance their knowledge on safe provision of wheelchairs, the prevention of secondary health complications and improved functioning of the wheel chairs (ASEN3 2011).

One of Shonaquip's main focus areas is in advocating for change in the distribution of funding and the quality of support services provided to people with disabilities. The organisation also works to educate funders and other development organisations about the long-term damaging effects to the wheelchair-user when using the wrong type or size of wheelchair (ASEN3 2011).

Shonaquip also offers training to therapists and health professionals on how to assess, prescribe, modify and fit mobility and posture support devices. Shonaquip also employs people with disabilities.

4.3.4 *Business Form*

Figure 6: Shonaquip Business Structure



Source: ASEN3 2011

The Social Enterprise has a Hybrid structure consisting of Shonaquip, the private company, and a newly formed Section 21 not-for-profit company called Uhambo Foundation. The structure of the organisation was changed from a close corporation to a private limited company to support its growth and has separated out the non-profitable activities into the Uhambo Foundation to ensure the sustainability the social initiatives. The Foundation's mission is to expand the scope of work to provide more advocacy and research, and to source funding for the unprofitable activities of Shonaquip's goals, including providing wheelchairs and support services to the poor.

4.3.5 *Products and Services*

Shonaquip manufactures and distributes wheelchairs, back supports, positioning and assistive devices, therapy equipment, communication devices and incontinence products. In addition, trained therapists assess, prescribe and fit positioning and seating equipment for persons with disabilities in their homes or in the surrounding communities, schools and hospitals (ASEN3 2011).

4.3.6 *Target Market*

Shonaquip’s clients are individuals who require specialised wheelchairs. The demand could come from the actual individuals or development agencies, governments, medical insurers and corporate companies who purchase devices and their services for people with mobility disabilities. Many of the employees within the factory also have disabilities and are wheelchair-users themselves which provides them with an excellent understanding of the needs of their clients (ASEN3 2011).

4.3.7 *Financial Model*

Shonaquip earns its income from the sale of wheelchairs, posture support devices, mobility products, clinical and training services. The pricing structure of the wheelchairs is differentiated based on the level of clinical service required and whether it is a government tender or a private sale. The largest expense of the organisation is salaries. 100% of the organisations income is earned (ASEN3 2011).

4.4 Pretoria Workshop for the Blind (PWB)

4.4.1 *Overview*

Head Office: Pretoria

Geographic Footprint: National and International

Annual Turnover: R17 million

4.4.2 *Background*

PWB started off as the Pretoria Society to help Civilian Blind in 1929 to provide sheltered employment to visually impaired people in the Pretoria area. In 1996 the name changed to Pretoria Workshop for the Blind to ensure that people understood that it was a work venue for the blind as opposed to being a care centre. The company trades under the name “Dreamhouse Workshop for the Blind” in order to establish a recognisable brand name with a logo (ASEN4 2011).

The organisation was close to bankruptcy and had to turn to a more business-like way of working in order to keep, sustain and grow the organisation. To this end, the organisation started manufacturing fertilizer sticks for the export market. Currently the orgainsation has three separate businesses and employees 60 full time staff, of which 45 have disabilities. Up to 100 additional workers are employed on a temporary basis for six months of the year, to accommodate peak packaging periods. When additional manpower is required for such contracts, preference is given to people with other disabilities and family members of blind employees. The company has won awards from both the business and social sectors (ASEN4 2011).

4.4.3 *Social Purpose*

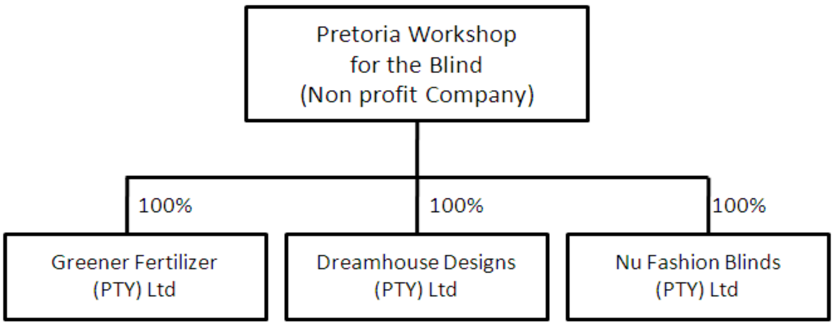
The main purpose of PWB is to economically empower people with disabilities. The organisation does this is by training people who are either blind or unemployed and providing them with a job opportunity in one of the companies. The big focus is on the Social Enterprise being a workplace and not a care centre, and thus the employees are expected to make their own transport arrangements to get themselves to work every day which fosters a sense of responsibility towards the job and shows respect for the person with the disability. The organisation is also looking to start hiring deaf people from a special school and will provide sign language lessons to their employees with sight in order that they may be able to communicate with the new employees (ASEN4 2011).

In order for the organisation to show society what people with disabilities can achieve, the Social Enterprise ensures that the quality of products is on par with or higher than others made by mainstream businesses. The organisation believes that this is a more sustainable way of impacting on the lives of these people and their families. The Social Enterprise also launched a profit-sharing scheme for staff in order to promote a sense of ownership of the company's success (ASEN4 2011).

The organisation also focuses on enterprise development for its employees where suitable employees are identified and trained to become independent entrepreneurs. This gives employees a chance to elevate their status and income, as well as create job opportunities for others. The organisation provides training, a workspace, and a starter pack of stock and tools to develop the entrepreneurs. As each enterprise grows, it will become a supplier to PWB (ASEN4 2011).

4.4.4 *Business Form*

Figure 7: PWB Business Structure



Source: ASEN4 2011

The Social Enterprise has a Hybrid structure. PWB is a section 21 non-profit company which trades under the name of DreamHouse Workshop for the Blind and is situated in Silverton, Pretoria. PWB has three subsidiary private companies, Dreamhouse Designs (Pty) Ltd, Nu-Fashion Blinds (Pty) Ltd and Greener Fertilizer (Pty) Ltd, which create employment for people with disabilities. PWB employs and trains the employees and places them within one of the three private for-profit companies of which it owns 100% of the shares.

4.4.5 *Products and Services*

Key factory activities include the extrusion and packaging of fertilizer sticks for the export market, the production and marketing of baskets and cane furniture, the assembly and packaging of products for various customers, and the assembly of venetian blinds.

The products that are manufactured and retailed by the three private companies, namely, Dreamhouse Designs (Pty) Ltd which manufactures the cane furniture, baskets, cushions and curtains, Nu-Fashion Blinds (Pty) Ltd which manufactures the aluminium venetian, wooden venetian and bamboo blinds, and Greener Fertilizer (Pty) Ltd which manufactures the fertiliser sticks for pot plants. Most of the income, approximately 80%, comes from Greener Fertilizer (Pty) Ltd.

4.4.6 *Target Market*

The clients of Dreamhouse Designs and Nu-Fashion blinds are primarily upper middle class individuals and families in Gauteng. However, with the increase in orders from their website, the target market is becoming more nationally widespread. Greener Fertilizer has a large export market in Europe for agricultural producers for about six months in the year (ASEN4 2011).

4.4.7 *Financial Model*

PWB owns all the company property and equipment for training the staff. The Social Enterprise's income is made up of the management fees and profits from the three companies (95%); the remaining 5% is made up of a subsidy from Department of Labour and a donation from the National Lottery Fund. At each financial year-end, if there are surpluses, 50% is shared with employees as a performance-based bonus and the balance is used to grow the business (ASEN4 2011).

Employees are paid on a "pay for performance" basis. All tasks have a value and it is up to individuals to work to their own ability and earn a wage according to their output. Members of the workforce who have a more significant disability than others are paid a higher rate to maintain the incentive. This model fosters a business-like culture and ensures that PWB remains competitive in its chosen markets (ASEN4 2011).

4.5 The Broccoli Project

4.5.1 *Overview*

Head Office: Cape Town

Geographic Footprint: Western Cape

Annual Turnover: R2 million

4.5.2 *Background*

Marc-Anthony Zimmerman, and Charles Maisel, joined forces in 2008 to create The Broccoli Project (hereafter referred to as Broccoli), an innovative Social Enterprise that uses specially-developed technology to monitor and measure donations. This is coupled with an incentive scheme which uses food vouchers to motivate the poor and unemployed to undertake positive behaviours. The initiative arose from many years of research on the Conditional Aid system supported by the World Bank and the Conditional Cash Transfer system where money is used in the exchange (ASEN5 2011).

Despite the idea being new in South Africa, Broccoli won second prize in the 2009 Global Entrepreneurship Competition in Barcelona. It was also voted the project with the most social value of all initiatives judged from across the world in the competition (ASEN5 2011).

4.5.3 *Social Purpose*

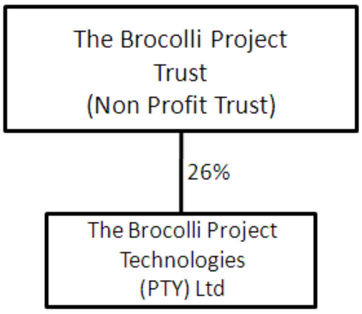
The two primary goals of Broccoli is firstly, to motivate people to undertake personally beneficial behaviours and secondly, to assist organisations or companies to monitor the implementation of their donations. As a pilot project, the Social Enterprise partnered with the Desmond Tutu Foundation and the Men on the Side of the Road project to facilitate HIV testing of thousands of men in the Western Cape area. Having seen the failure of many other voluntary testing campaigns, the social entrepreneurs realised that if someone is poor, their main priority would not be to check if they have a disease, but rather to source food. This led them to create the food voucher system as an incentive scheme that works together with the tracking system (ASEN5 2011).

In the pilot, the Desmond Tutu Foundation provided the medical testing; Men on the Side of the Road brought the men to be tested and Broccoli provided the tracking and voucher system. The system uses fingerprint technology to verify that the person has taken the test and records their medical history. Once this is done, the volunteers are given food vouchers that can be redeemed at Pick n Pay outlets. The technology is useful in helping donors to see if its grants are really reaching the people intended while incentivising disadvantaged people to have the correct behaviours (ASEN5 2011).

The system can also be applied to other socially positive behaviours, such as attending school or training courses, undergoing specific medical procedures and practising environmentally beneficial activities (ASEN5 2011).

4.5.4 *Business Form*

Figure 8: The Broccoli Project Business Structure



Source: ASEN5 2011

The Social Enterprise uses a Hybrid structure consisting of The Broccoli Project Technologies, a private company, and The Broccoli Project Trust, a registered non-profit trust which owns 26% of the private company. The company structure was chosen since the initiative is very capital intensive and required venture capital funds, whilst the non-profit allows for tax benefits. The remaining 74% of the shares are held by the CEO and another director. Due to the Social Enterprise still being very new, no dividends have been paid thus far. The Trust administers the charitable activities that are linked with the incentive scheme.

4.5.5 *Products and Services*

Broccoli has developed and sells the technology for the monitoring of donations provided to large numbers of beneficiaries. The incentive scheme is used in combination with the technology. A separate product developed by the Social Enterprise is a non-incentive based food voucher which allows people to give to beggars and other poor people in a more productive way than just donating money. The voucher can be exchanged at major retailers for basic food staples such as bread, milk, maize meal or vegetables (ASEN5 2011).

4.5.6 *Target Market*

Broccoli targets national and international non-profit organisations, development institutions and companies for the sale of its technology. Government is also being targeted as a potential client.

4.5.7 *Financial Model*

Broccoli earns its income from sales of the self-contained system with the fingerprint technology and through advertising on vouchers. The company has recently won a contract which will see The Broccoli Project technology and incentive scheme being used to establish HIV status, motivate educational performance and develop life skills in consenting Grade 9 and 10 learners in fourteen rural schools. 100% of Income is earned and the Company does not rely on any grant funding (ASEN5 2011).

5 FINDINGS

The findings are broken down into three parts in an attempt to answer the three research questions. The three research questions are:

4. What is the rationale for a Social Enterprise to create a Hybrid model?
5. What are the challenges that a Social Enterprise is faced with when creating and maintaining a Hybrid business model?
6. What impact does moving to the Hybrid business model have on a Social Enterprise?

Interviews were carried out with:

- Elize Stroebel, CEO of JHC; Natalie Killassy, founder and CEO of Stitch Wise; Shona McDonald, founder of Shonaquip; Deon Cronje, COO of PWB; and Marc-Anthony Zimmerman, co-founder and CEO of The Broccoli Project

Table 4: Findings

	JHC	Stitch Wise	Shonaquip	PWB	Broccoli
(1) Rationale for setting up the Hybrid model					
Innovative and wanted to try new things	YES	YES	N/A	N/A	YES
Wanted to issues shares	YES	YES	YES	N/A	N/A
Wanted to move always from relying solely on Donor Funding	N/A	YES	YES	YES	N/A
Wanted to be able to set own strategic objectives	N/A	YES	YES	N/A	N/A
Was a case of survival rather than expansion	N/A	N/A	N/A	YES	N/A
Ensure that the company was always able to deliver on its promises to it stakeholders	YES	YES	YES	N/A	N/A
Made sense to have separate billing entities	N/A	N/A	N/A	N/A	YES
(2) Challenges of setting up the Hybrid model					
Getting everyone to understand the model and participate	YES	N/A	YES	N/A	N/A
Need to be able to get control of the entity without the equity	YES	N/A	N/A	N/A	N/A
High Costs involved	YES	YES	YES	YES	YES
Culture Clashes					
Bureaucracy and time consuming process	YES	N/A	YES	YES	N/A
(3) Impact of setting up the Hybrid model					
Opens up alternate sources of funding and allows you to become self sustainable, independent and achieve surpluses	YES	YES	YES	YES	YES
Raised profile and become more marketable	YES	YES	YES	YES	YES
Increased Reach	YES	YES	YES	YES	YES
Improved Cost Efficiencies	YES	YES	N/A	YES	N/A
Mission Drift	N/A	N/A	N/A	N/A	N/A
Have become too business orientated	N/A	N/A	N/A	YES	N/A
Great learning and growing experience	N/A	N/A	YES	N/A	YES
<u>**Key**</u> **YES** - Was specifically mentioned in the exploratory interview **N/A** - Was not mentioned in the exploratory interview					

Table 4 above, is structured according to the three research questions, and highlights the common reflections that came out of the interview data for each of the research question. The next three sections will highlight the common findings and integrate this with the literature and the actual interview data.

5.1 Rationale

This section seeks to answer the first research question by trying to understand what was the rationale for creating the Hybrid business model.

5.1.1 *Social Enterprises see themselves as innovators*

(Zahra, Rawhouser, Bhawei, Neubaum, & Hayton 2008) identify that "Social entrepreneurship encompasses the activities and processes undertaken to discover, define and exploit opportunities in order to enhance social wealth by creating new ventures or managing existing organisations in an innovative manner." This came out strongly in the interviews with three of the five interviewees indicating that part of the rationale for moving to a Hybrid business model was in an attempt to be innovative and try new things. Elize stated that:

"We are not just a social housing company, even though that's our core business. That's just one portion of our business. We try and do things that nobody else has done, or can do, and also test to see if it works or not…..For JHC it was because we are like a Social Entrepreneur wanting to try new things… JHC has done that throughout the years. We test models for the sector and then we make it available…"

Similarly Marc identified that:

"The Broccoli Project began as an experiment in food security…..at the time I had been reading a lot of Mohamed Yunus and a CK Prahalad's writings which inspired me to believe that making a profit and making a difference were not mutually exclusive endeavours… "

This is also highlighted by Hynes (2009) who puts across that in trying to achieve social change, social entrepreneurs are viewed as innovators where a focus on process innovation was viewed as an important means of creating a competitive differentiation. From these statements it appears that Social Enterprises, by their very nature of, seem to be drawn to the more efficient hybrid model structure.

5.1.2 *Needed a capital injection and wanted to issue shares*

Undercapitalisation is a major problem in most Social Enterprises, particularly for capital intensive enterprises such as manufacturing. For-profits have the ability to raise equity investments that, depending on the local laws, are not an option for non-profit entities, whose assets are considered publicly owned (Legal Resource Centre 2011). There are two elements that came out of the interviews regarding this. The first being the ability to attract private investors and the second, being able to incorporate staff as shareholders. Both are discussed separately below.

a. *Attract Private investors*

A for-profit entity has flexibility regarding the distribution of profits and payments can be made to owners and investors in the form of dividends as well as having the ability to re-invest back into the entity for the social purpose. A for-profit entity will also find it easier to access some forms of debt that non-profits would find hard to get (Legal Resource Centre 2011). Elize highlights this point below:

"We first wanted to test how it would work if the private sector was an equity partner in a deal because in that point in time, there was not much problem in finding debt funding, the big problem was equity funding…. If they came into a section 21, they would not be able to have an out and they would not be able to get a return…"

Shona similarly affirms that:

"I then formed a PTY, as it would give me an opportunity to have shares, and my logic was that I could start another company, an NPO this time, and transfer some of the shares to the NPO, so that as the company was forced to grow and expand and become more competitive, it wouldn't lose its soul…"

These statements support the rationale that Social Enterprises form a Hybrid business model to try and attract private investors in an attempt to grow and expand.

b. *Incorporate staff as shareholders*

From an internal viewpoint employees are a key resource and enabler in the successful achievement of the vision of the social entrepreneur. Retaining staff in a non-profit may not always be an easy task as the lack of financial resources, inability to guarantee job security or provide attractive salaries renders it a challenge for the social entrepreneur. These issues are somewhat solved in a for-profit legal where the company may offer important employees higher salaries and share options (Hynes 2009).

This reasoning was particularly prevalent in Stitch Wise where the Employee Trust owns a portion of the Private Company (Figure 5). The Model allows employees to get dividends from the company, however the dividends is based on performance, and that creates a very efficiently run operation where disadvantaged people can directly contribute to their own upliftment. Natalie emphasises that in the following statement:

"…It then becomes about business principals, and they become totally committed like any other shareholder in the business, where you take responsibility for your time and attendance, your quality of work etc…"

PWB uses and interesting methodology to getting around having employees owning shares in the Social Enterprise, but is still able offer them a share of the profits. Deon points out the alternative below:

"We used to have profit share, but we have changed this to a 13th cheque, whereby if there is profit at the end of the year, half the money goes back into the business, and the other half gets paid out amongst everyone in the form of a 13th cheque on a performance basis….Because it's a non-profit, there are no shareholders, and that's why the terminology of a 13th cheque is used…"

5.1.3 *Wanted to move away from relying solely on donor funding*

One of the main reasons for moving to a Hybrid model is to open up alternate sources of funding so that the organisation could become more self-sufficient. A move to a Hybrid model will allow the for-profit entity to facilitate investment, while the non-profit entity can facilitate grant capital (Kelley 2009). This type of organisation has much greater flexibility and freedom of choice, not to mention the contribution such funding makes to financial self-sufficiency (Mair and Marti 2006). Deon illustrates this point below:

"…the workshop almost went bankrupt, and the current MD took over and the biggest problem was government grants. All the grants started drying up. So they didn't have money to pay the people for any work done, and that's when they decided to take a more business orientated approach….therefore it was very much survival rather than expansion…it was change the way you operating or close down…"

This supports the rationale highlighted in the literature which assets that Social Enterprises form a Hybrid business model so that they can move away from relying solely on donor funding and can become a more sustainable orgainsation.

5.1.4 *Strategic agendas are driven and shaped by funders*

Non-profits face the possibility of external funders stipulating how their funds can be spent. Such restrictions on the nature and scope of activities can limit an organisation's autonomy in deciding how to best meet their clients' needs. In turn, the organisation's opportunity for self-sufficiency and sustainability is constrained (Diochon and Anderson 2009, Austin *et al* 2006). The prospect of financial support from governments and other institutions such as the World Bank is alluring which makes their strategic agendas driven and shaped by the priorities of these funders (Diochon and Anderson 2009).

This point came out strongly in the interviews. Natalie emphasises this in the passage below:

"Funders want to support HIV/Aids one year and next year they want to support education for instance…. You need consistency of funding for your NGO, and the biggest issue is getting foundations to commit to the long term, and this is determined by who is making the decisions in the foundation…This for me is where your NGO can fail, as you continuously have to focus on motivating for why you need funding, all the time, and there are a lot of safety nets and clauses that stipulate that you can only operate in a certain way….this is not the Stitch Wise way"

Similarly Shona states:

"I have had bad experiences starting two NGO's, where funders changed and shifted their interest in what they were supporting from one thing to another depending on the flavour of the day. I watched projects we had started closing down because funders no longer wanted to fund disability, they wanted to fund HIV Aids for example….they were also no longer giving funding to individual NGO's, they wanted to give it through the National Development Agency which was set up to distribute money more equally….this led to a number of NGO's, like myself not being able to deliver on their promises to their stakeholders"

This was a key rationale for the move to a Hybrid business model and allowed the social enterprises the ability to become self sustainable and have long term view on the projects they undertook.

5.2 Challenges

This section seeks to answer the second research question by trying to understand what are the key challenges that a Social Enterprise will face when creating the Hybrid business model, and how they could overcome these challenges.

5.2.1 *Getting stakeholders to understand the model*

One of the challenges in moving to a Hybrid business model was it was a difficult concept to understand and position to potential investors and donors (Kelley 2009). Elize highlights this point below:

"One of the main challenges was getting everyone round the table to understand the model and to agree to participate. The challenge was for everyone to take up the concept of partnership, participate in that partnership and make it work…"

Shona also faced a similar challenge and identifies that:

"The other challenge was that funders were quite slow in understanding Social Enterprise. They have been stuck in the charitable models…"

This is a challenge that Social Enterprises will have to go through and one of the consequences of this is that it may take a long time to find suitable funders.

5.2.2 *Getting control of the entity without having the equity*

Another challenge that came out of the interviews is that Social Enterprises generally do not have the equity capital needed to gain a controlling stake in the newly formed entity. It is important for the Social Enterprise to have a majority stake, in order to ensure that the social mission of the organisation is not compromised by the new partners. Commercial activities of a Social Enterprise, while useful in furthering a social mission, also introduce economic pressures that can pull an organisation away from social mission activity (Gair 2005).

One of the ways to get around this challenge is to get other parties to contribute as well as the possibility of get soft debt funding. Elize highlights this issue below:

"JHC's biggest challenge was to get JHC not to put huge amounts of equity into the deal, because JHC didn't have the equity to be able to get a majority shareholding…so what JHC did is a partnership with private enterprises like Anglo, who contributed. Government contributed

towards subsidies of the properties and the land, and this made JHC's share of equity into the whole project with ABSA and Government….This may be a challenge for other entities as well, is how do you make up your own equity to remain in control of the Hybrid, because you need too, otherwise the entity can lose focus….If you could get soft debt funding, that would work…"

5.2.3 *High Costs involved*

The costs involved in putting together a Hybrid structure may be an issue for many smaller Social Enterprises. All the Social Enterprises interviewed agreed that one of the main challenges in moving to a Hybrid structure is that the costs can become quite expensive. Elize mentions that it's not just hard costs but soft costs in terms of time and reporting:

It's also not just hard cash. It's the soft costs of time and reporting and that's where small entities fall short because they don't have the capacity…What funders want from day one, is information on who are the LSM groups being serviced, what is it you are doing…. all this information needs to be gathered, stored, and put into a format that you can report on, because social reporting is crucial….if you don't have that capacity, you going to battle to get funding. You might initially get it, but then you going o find it hard to sustain it..."

Shona also emphasises this:

"…this process is extremely time consuming, and takes your eye of what you normally should be doing, you need to find the right people to help you in this process, because it is quite distracting…"

However this is not a hurdle that is insurmountable. Deon from PWB identifies that Social Enterprises needed to try and get the right people onto their board of directors, in the form of a lawyer and accountants which will help with the process. Marc indicated that Social Enterprises going down this route should try and get the legal and accounting costs handled by a firm as part of their pro-bono work so as to reduce the costs as much as possible.

5.2.4 *Culture Clashes*

Another challenge is that there may be culture clashes with the two different entities with regards to competing work cultures within the two organisations as well as transparency issues (Kelley 2009). Natalie highlights the following ways to try and ensure that there are no issues with culture conflicts:

"I think being a Social Enterprise our culture is the same as a non-profit. It needs to be driven from the values of the business and the purpose it was set up….Make sure you are employing people with the same mindset and culture as this can have a very negative effect on your company. If you have the right crew steering the ship with the right culture, that will make all the difference…There are a lot of NGO's that think that if they made a profit, it would change the people, but you need to have the right people to maintain the culture…"

However, none of the Social Enterprises that were interviewed indicated they had experienced culture clashes in their organisation after the move to a Hybrid business model and it seems that this is not a key challenge.

5.2.5 *Bureaucracy and time consuming process*

Something not mentioned in the literature but that came out of the interviews as a major frustration in moving to a Hybrid business model was that it was a very bureaucratic and time consuming process. One of the ways to minimise this is to not do the conversion in a busy time of the year for the organisation. Shona highlights this below:

"The biggest frustration in the process was bureaucratic….Changing the company had huge ramifications, not at the bank were we expected a problem, but in terms of BEE certification, our registration with department of health, with procurement officers, with the treasury department, every single thing had to be changed. Every registration certificate with every hospital we had ever supplied has to be changed. They refused to put us back on as a tender supplier until we had registered every document. There were also huge delays in order processing….I don't think there is any way to do this more efficiently. I think if I had known what to expect, I maybe would have done it at a different time of the year and not in our busy tender period as it affects everything…"

5.3 Impact

This section seeks to answer the third research question by trying to understand what is the impact that moving to a Hybrid business model could have on a Social Enterprise.

5.3.1 *Opened up alternate sources of funding*

Traditional lenders such as banks are hesitant to make loans to non-profits on competitive terms because they are aware that a non-profits' ability to repay the debt is constrained by the lack of access to other sources of capital (Kelley 2009). One of the main outcomes of going down the Hybrid business model, highlighted in the interviews, is that it has allowed the Social Enterprises to access alternative sources of funding like Bank and Enterprise Development funding. This has allowed the Social Enterprises to become self sustainable, independent and achieve surpluses. Elize identifies that:

"It was wonderful for our bottom line because that's one of the things you find in pure non-profits. Non-profits look to just cover costs, people don't look at how much surplus you can create out of your business. So it allowed us over a period of time to generate enough profits into the group to expand. So our organic growth has been much quicker than some of the other entities because of the model… It really helps you to become sustainable and to remain sustainable…"

Dean agrees and states that:

"The Hybrid has opened up alternative avenues of funding. You are able to raise money from banks, whereas if you were a pure non-profit, this would not be possible as you wouldn't be able to pay back the money…"

Marc further adds:

"…by going the Hybrid route and the type of product we have been developing, we were able to take part in a wide range of entrepreneurial activities…"

This was common amongst all the Social Enterprises interviewed and it appears that having a Hybrid business model enables a Social Enterprise to access both private and donor funding and thus become more sustainable.

5.3.2 *Raised the profile and made the organisations more marketable*

Social Enterprise's would be hesitant to use a for-profit entity because, while for-profits create a public image of being efficient and business- like, which may attract customers in some situations, there is a large negative stigma attached to for-profits operating in the social sector which can mean that even if the for-profit is doing the right thing, they can be attacked for having ulterior motives (Hamaoui 2005). This is one of the major deterrents of Social Enterprises changing to a Hybrid model. Elize states that:

“The impact on our image has been very positive. They see us as a non-profit doing good, and realise that it is a sustainable financial model… that’s call “impact investing” because you provide them both a financial and a social return…..you will see it in King 3 about socially responsible investing. It’s not about CSI funding, it is about big investors saying I’m happy to take a reduced financial return, if they provide me with a social return as well…”

Deon agrees and states:

“It has definitely had a positive impact. People come here now and they are impressed by what they see and they want to do business with us, whereas if it was a traditional non-profit, they may feel sorry for us, but they won’t be so eager to do business with us….and example of this is that we now we get companies like Anglo American who are willing to help us in the form of Enterprise Development. We can use them as an alternative….they will lend us the money at very low interest rate…”

Deon also states that it had a somewhat of a negative impact:

“From a fund raising point of view, the model has been somewhat of a disadvantage because we are a thriving business, funders are hesitant to give us grant funding…”

Elize’s advice on how to get of any negative association to the model is:

“the other thing is reporting….if you got existing guys that are providing you with grant funding and you do this, it is very important that you provide them with feedback and the rationale for this and where this money is going. If they provided you with grant funding for the group, you need to be able to give feedback on how the surpluses that are being generated is not going to the private sector, and how it will come back to the entity. JHC has been very good at doing this. Corporate reporting is crucial to keep old and new investors happy…”

The other impact on the image is that it has made the Social Enterprises more marketable and actually encourages funders to want to do business with you. Elize identifies that:

“JHC won the habitat for humanity award for this specific financial structure and design….It raised our profile both locally and internationally…had a huge impact on our marketing profile…”

Shona concurs with this and stated that:

“It is attracting attention….It provides a lot of clarity for our shareholders because we are doing what we say we are doing…”

The interviews show that it has had a positive impact on the image of all of the Social Enterprises interviewed, with one interviewee highlighting that there was both a positive and negative impact but overall a positive one. The negative effect was from a donor funding perspective where donors are hesitant to a give a for-profit funding. The method to improve the image from fund raising point of view is to give donors constant feedback and the rationale for the shift to the Hybrid model.

5.3.3 *Improved Cost Efficiencies*

Another impact of the Hybrid model reported by three of the Social Enterprises is that it led to cost efficiencies in the running of the business and allowed the business to scale up and reach more people. This is as a result of moving to a more business like orientation which seeks out efficiencies in order to compete effectively. Natalie highlights this below:

"By bringing in the previously disadvantaged employees as shareholders of the Trust, and because the dividends is based on performance…. this creates a very efficiently run operation…. efficient because employees have a stake in the business and therefore their quality of work is better, their absenteeism is less etc. and this allows us to grow our business and reach more people…"

5.3.4 *No "Mission Drift" experienced on the social objectives*

One of the question marks of moving to a Hybrid model was that it may not be able to provide some assurance to a social mission-focus which includes the promise to reinvest any excess assets back into the organisation's social mission work rather than distributing them to individuals. The issue was that some of the commercial activities, while useful in furthering a social mission, would also introduce economic pressures that can pull an organisation away from social mission activity (Gair 2005).

None of the Social Enterprises reported mission drift after moving to the Hybrid business model. Elize indicates that it is important to choose your investors carefully in order to ensure that mission drift does not occur:

"You need to choose your investors very carefully because at that point in time it was crucial for us to bring in investors that have the same objectives as JHC. You shouldn't just open this up to everyone. You need to be very careful. There needs to be alignment of interests between the investors and the non-profit to make sure that your focus is the same….I think JHC achieved this

as we never really separated the two companies. It was always as a group. Whatever we did, the social objectives were never lost…"

One of the Social Enterprises reported that the Hybrid model may have made them too business orientated and Social Enterprises going down this route should be wary of this. However this has not led to mission drift as their model ensures that as they grow, more of their social objectives are met. The issue relates to not fully capitalising on grant funding. Deon from PWB states:

"We have almost become too business orientated because we maintain we are not a charity. We don't give anybody charity and I think we may be falling into a trap being to business like. There is definitely an avenue for us to get more grant funding as we are not a pure business; we do a lot of social good. It is definitely an opportunity we are not capitalising on because we are trying to be like a normal business and a normal business doesn't do that.... we need to come back a little and find a nice Social Enterprise space…"

5.3.5 *It allowed the organisations to increase their Reach*

The overall aim of creating a Hybrid Social Enterprise would be to enable a Social Enterprise to scale up their operations and improve their social impact in a more sustainable way. All the Social Enterprises identify that the model has allowed them to reach more of their constituents. Elize identifies that:

"It has allowed us to do a lot more community development work. A lot of the surpluses that are generated out of the group we can channel into Makhulong A Matala….The annual budget for Makhulong A Matala is about R5m and we wouldn't be able to do this without the model…"

Deon also highlights the increased reach the model has enabled them to achieve:

"Our reach improved significantly…there were 15-20 people employed previously when we were a pure non-profit, we had very few contract workers, and the facility was very small….The move to a formal business allowed the company to expand and get a bigger building, which allowed us to take on more work and therefore more employees….We currently have about 65 permanently employed workers and can easily take on another 190 contract workers in our peak season…"

By reaching more of their constituents, Social Enterprises are able to have a greater impact on society, and this may justify the costs associated with moving to a Hybrid model.

6 CONCLUSIONS

The subject of Social Entrepreneurship and Social Enterprise is a complex one as is still in its infancy, especially in South Africa. A Social Enterprise is any business venture created for a social purpose to reduce a social problem or market failure, while using a financially sustainable business model with mechanisms for ensuring accountability to its beneficiaries (Alter 2004).

There is a growing interest in Social Enterprise in South Africa, which can be seen by the increase in activity in the space. The impetus for this interest is in part driven by perceived advantages that Social Enterprise has over the government in efficient delivery of services; over conventional business relating to questions of trust, accountability, and purpose; and over charities and NGO's due to financial sustainability and access to capital (Fury 2010).

Social Enterprises therefore have a special role in emerging markets like South Africa. This is evident as there are an increasing number of Social Enterprises that are being launched in South Africa (Fury 2010). However there are still a lot of questions relating to how to structure the Social Enterprise. Entrepreneurs want to figure out the most advantageous legal structure for their social mission activities and philanthropists want to make sure they are not ignoring innovations in social change efforts (Gair 2005). The desire to combine a social and commercial business model has led to creative ways to structure an enterprise, often known as a Hybrid model, because it combines the non-profit entity with a for-profit subsidiary. The for-profit allows an enterprise to facilitate investment, while the non-profit can facilitate grant capital and provide non profit-making services to a community (Clinton 2009). The Hybrid model is seen as a possible solution to the bringing together of social mission and business practices (Gair 2005).The purpose of this research was to seek a better understanding of the reasons that make Social Enterprises establish a Hybrid business model.

The research analysed five Social Enterprises in South Africa that went down this route therefore generalisations to the greater population are limited. However some conclusions regarding a Social Enterprises move to a Hybrid business model may be drawn from this sample as the in-depth interviews allowed for deep insight into this currently uncommon Social Enterprise phenomenon, and therefore can contribute to the knowledge base surrounding the subject of Social Entrepreneurship.

The first part of the research set out to test whether the rationale for moving to a Hybrid business model corresponded to the literature for such a move. One of the key findings was that the Social Enterprises see themselves as innovators and want to try new things to achieve social change. One of these innovative process improvements was to move to Hybrid business model so that they could attract alternative sources of funding in an effort to move to more sustainable model of helping their beneficiaries.

The justification for wanting to move a Hybrid business model was firstly, a way for Social Enterprises to issue shares. Issuing of shares allowed the Social Enterprises to attract private investors so that they were able to access alternative means of funding, because private investors required a financial return. The ability to issue shares also enabled some of the Social Enterprises to incorporate staff as shareholders, in cases where staff were also the primary beneficiaries of the social program. This allowed for staff to contribute and benefit directly to their own upliftment.

Another reason for moving to the Hybrid Social Enterprise business model was to become more self-sustained and independent which would allow the organisation to be able to always deliver of their strategic objectives. The ability to become more self-sufficient meant that the Social Enterprises strategy did not need to be shaped by the priorities of prospective funders who place restrictions on the nature and scope of activities that an organisation can do. By going down the Hybrid business model route, the Social Enterprises could have the autonomy in deciding how to best to meet their constituents needs, which in many cases, the funders were not the experts on.

The second part of the research looked at the challenges Social Enterprises faced with creating and maintaining the Hybrid business model. There were three main challenges that emerged from the research as possible stumbling blocks when moving to a Hybrid business model. These related to getting stakeholders to understand the model and agree to participate, the process was very time consuming which could take your eye of other more pressing needs and that the costs involved in moving to Hybrid model were quite substantial. Of these challenges, the high cost involved in putting together a Hybrid structure may be an issue for many smaller Social Enterprises trying to go down this route. To get around this obstacle, the Social Enterprises should try to get the right people on your board of directors, in the form of a lawyer and accountants which will help with this process as well as to try to get the legal and accounting costs handled by a firm as part of their pro-bono work so as to reduce the costs as much as possible.

The final part of the research looked at what impact did moving to the Hybrid business model have on a Social Enterprise. The main rationale for moving to the Hybrid business model was to allow the orgainsation access to alternate sources of funding. With regards to this, the research indicates that it did allow the organisation to access alternative sources of funding which included Bank and Enterprise Development funding. This has allowed the Social Enterprises to become self sustainable, independent and achieve surpluses. This was common amongst all the Social Enterprises interviewed.

Another common outcome of the model was that it raised their profile and made the organisations more marketable. The interviews show that it has had a positive impact on the image of all of the Social Enterprises interviews, with one interviewee highlighting that there was both a positive and negative impact but overall a positive one. The main reason for the positive image benefits was that the Social Enterprise's were now able to offer both financial and social returns to investors.

The literature highlighted that one of the main issues of moving to a Hybrid model was that it may not be able provide some assurance to a social mission-focus which includes the promise to reinvest any excess assets back into the organisation's social mission work rather than distributing them to individuals. None of the Social Enterprises reported mission drift after moving to the Hybrid business model and the interviews highlighted that Social Enterprises going down this route should choose their investors that had similar objectives which should serve as way to prevent mission drift from occurring.

Finally, the overall objective of any Social Enterprise creating a Hybrid Social Enterprise would be to enable the organisation to scale up their operations and improve their social impact in a more sustainable way. All the Social Enterprises identify that the model has allowed them to reach more of their constituents which may justify the costs, time and bureaucracy attached to moving o the Hybrid business model.

It must be noted that there are very few Social Enterprises that have gone through the process because the outcomes are not widely known. Thus generalisations from the findings are somewhat limited.

A recommendation for future research is to examine the critical success factors involved in a non-profit organisation moving to a Hybrid business model. This would be beneficial to the large number on non-profit organisations in South Africa that currently rely solely on donor funding and are struggling to have a more sustainable impact on their constituents.

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APPENDIX A: LETTER TO RESPONDENTS

Dear Respondent

I am completing my MBA at the University of Witwatersrand (Wits) in Johannesburg. My MBA thesis is on Hybrid Social Enterprises, specifically focusing on the rationale for choosing this business model, the challenges faced in implementing the business model and the impact that the business model has made to the Social Enterprise.

I would be grateful if could meet with you for an approximately one hour long interview to discuss this with you. Confidentiality will be observed throughout the thesis process and the final report will be for academic purposes only.

I will be able o meet at any location you choose at a time of your convenience.

Your help with this will be greatly appreciated.

Yours Sincerely,

Daryl Rajah

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APPENDIX B: SOCIAL ENTEPRISE SELECTION AND INTERVIEWEES

No.	Social Enterprise	Name on Interviewee	Position in Organisation	Date of Interview
1	Johannesburg Housing Company (Pty) Ltd	Elize Stroebel	CEO	December 7, 2011
2	Dreamhouse Workshop for the Blind	Deon Cronje	Head of Operations	November 16, 2011
3	Shonaquip (Pty) Ltd	Shona McDonald	Founder and Chairman	February 7, 2012
4	Stitch Wise (Pty) Ltd	Natalie Killassy	Founder and CEO	January 25, 2012
5	The Brocolli Project (Pty) Ltd	Marc-Anthony Zimmerman	Founder and CEO	February 17, 2012

APPENDIX C: RESEARCH INSTUMENT

<u>Interview Questions</u>

A) Rationale Questions

1. What was the rationale for moving to a Hybrid model? (What was not working, what was working?)

2. What circumstances made this conversion appropriate? (For instance, you may want to change status because you seek investment funds to smooth fluctuating cash flow so that you can offer consistent services. Or the majority of your income derives from sales, and for-profit status may enable you to expand beyond "mission-related items.")

B) Challenges Faced Questions

(Aim: To understand what the challenges that non-profit Social Enterprises looking to move into a Hybrid business model should aware of (how to separate organisations, tax issues, culture conflicts, different goals etc.)

3. What was your organisational structure before and after the Hybrid?

4. Did you experience any legal issues in changing to a Hybrid structure?

5. The costs; how easy was it to set up the Hybrid structure? What kind of ongoing management (bureaucracy) and accounting costs are associated with it?

C) Impact Questions

6. What kind of opportunities was opened to your organisation after going down this route?

7. Did the move have the desired impact?
8. Did going Hybrid reduce the pressure to raise money?

9. Did you achieve any cost efficiencies, increased effectiveness or reach improvements?

10. Did switching to a Hybrid model negatively or positively impact your image? Do you get the same response from donors or is there some scepticism?

11. Did you experience any unexpected consequences or opportunities?

12. Can a Hybrid model be abused? How do you prevent this?

13. In your experience which is harder: raising money, building a successful organisation, or achieving real impact?