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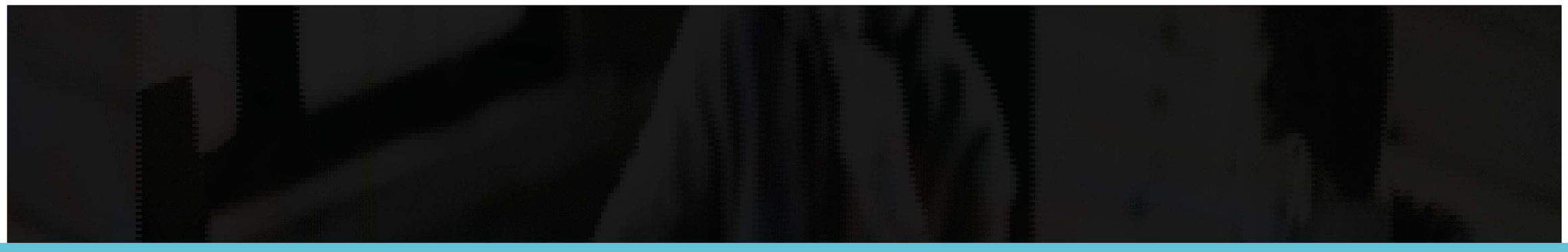
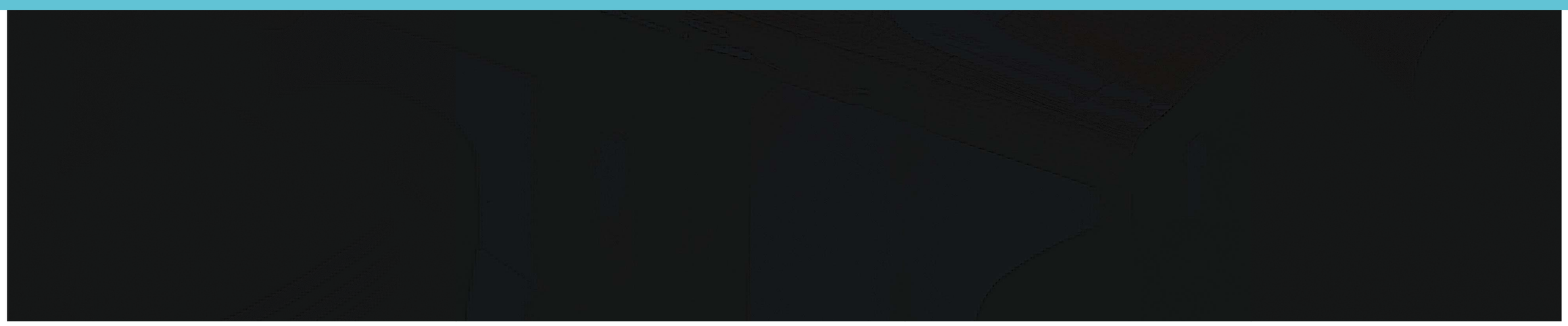


POLICY PAPER

PROMISING FINANCIAL & SUPPORT MECHANISMS FOR SOCIAL ENTERPRISES

Partners Albania for Change and Development

February 2021



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Abstract

Based on the findings stemming from the baseline study "Characteristics and Challenges of Social Enterprises in Albania", social enterprises in Albania have poor knowledge on doing business and certain financial mechanisms, since they generate revenues solely from traditional sources such as grants.

This policy paper aims to draw attention to promising financial and support mechanisms, which could help startups and social enterprises in their early stages to jump into the market and become sustainable.

The paper outlines the characteristics of business incubators, accelerators, business angels, and venture capital funds as the most prominent mechanisms used nowadays. The paper explains how these mechanisms function, what do they offer, differences between them, and their role related to social enterprises. The paper provides several policy recommendations based on European best practices targeting decision-makers aiming to enable the ecosystem for these mechanisms to thrive.

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Introduction

Access to financial mechanisms is a continuous challenge for social enterprises. Taking into consideration the social mission and the type of users these entities serve makes access to funds rather difficult. Investors find these entities not attractive enough because they present a high risk and lower return to investment rates (European Commission, 2020).

The most discussed concept nowadays related to investment on social enterprises is **impact investment**. Impact investment aims to create beneficial and measurable social and environmental impact besides financial return. Impact investments can happen in both emerging and developed markets and target a range of returns from below market-to-market rate, depending on investors' strategic objectives. In general, capital is invested for critical challenges ranging from sustainable agriculture, renewable energy, conservation, microfinance to affordable and accessible basic services such as housing, healthcare, and education. The global market size of impact investment is around $ 715 billion (Hand, Dithrich, Sunderji, & Nova, 2020).

Impact investment is conducted across various sectors. High net worth individuals, foundations, pension funds, institutional investors, and social venture capital funds, investors who invest capital directly in social enterprises (i.e., Acumen Fund, Bridges Ventures), and social impact bonds make social impact investments. Receivers of the capital can be both for-profit and not-for-profit entities as long as they can produce a financial return (UNDP, 2016, p. 1).

Usually, entrepreneurs, including social entrepreneurs, use their savings or loans from their relatives as initial capital to start an enterprise. Banks and other private investors tend to be reluctant to provide loans or capital to social enterprises (SE) in particular in their first stages (Carpenter & Lauritzen, 2016, p. 5). The founder of Social Venture Fund, Weber *(2012)* states that "*If entrepreneurs depend on donations, they will reduce efficiency; the real scaling can function only by getting an investment*".

Concerning the expansion of social enterprises, other funding sources become helpful such as crowdfunding, competitions, fellowships, business incubators and accelerators. Business angels and venture capital seem to be suitable sources in the stages SEs seek funding to scale. Below there is a presentation of some main sources of funding suitable for social enterprises in different stages of their business life cycle.

Crowdfunding is an emerging source of financing related to open calls addressed to the public, using the internet aiming to finance projects through financial contributions in exchange for a reward, product, lending, or investment. Most popular types, which could be used by social enterprises, are reward-based, where funders, called "backers", support the campaign, and receive a product in exchange. Another type is equity crowdfunding, where investors receive shares of the companies in exchange for their capital. Another type is debt-based crowdfunding, where backers pool their funds into a loan, and the enterprise is assumed to repay with interest (European Commission, 2015).Various statistics show the huge potential of crowdfunding while donation and reward crowdfunding have raised $ 5.5 billion; equity crowdfunding& debt-based crowdfunding have raised $ 2.5 billion and $ 25 billion, respectively (Fundly, 2020).

Competitions are programs, which are increasing exponentially with the rise of social entrepreneurship. These programs are usually established by non-profit organizations, universities, etc., which provide resources and support to startups to grow and make their ideas happen. In general, competitions function with an application and selection process, which sometimes comes with funding or not. Hult Prize is one of the most well-known competitions for social entrepreneurs dedicated to students who undertake to address an emergent challenge related to a large market. The prize awards $1 million to a team (Acumen Academy, 2019).

Business incubators are support structures, which support entrepreneurs in their conceptual ideas and their development. The main aim is to increase the chance of success for all the business ideas (Bruneel, Ratinho, Clarysse, & Groen, 2012).

Business Accelerators are related support for entrepreneurs, which speed up the process of business creation and invest capital in those startups, which present high potential. Business Accelerators are considered as separated from business incubators, even though these structures share plenty of similarities (European Commission, 2019).

Business Angels are private individuals, usually with a high net-worth and considerable business experience, that directly invest part of their wealth in new and growing private companies (European Commission, 2017).

Venture capital is a form of private equity usually provided in large sums to startups representing growth potential. Venture capital is provided by high net worth investors, investment banks, and any other financial institution. The financial investment sometimes is accompanied by technical and managerial expertise (Chen & Scott, 2020).

Social venture capital functions as the traditional venture capital, but in comparison to the latter, this is destined for social enterprises. This type of capital is invested in companies, which generate either environmental or social impact besides the financial return (Luenendonk, 2018).

Another financial mechanism of importance for startups is **debt funding**. The entrepreneur must pay back the full amount plus interest accumulated for the respective period. There are two types of banks involved in the financing of social enterprises. One group represents commercial banks, which have established services for social enterprises (i.e., Erste Bank). The second group refers to banks known as community banks, ethical banks, or social banks, and are organized in networks. Also, there are intermediaries, which play the role of a matchmaker between social enterprises and structure investments. Their business model is typically based on a fee. The Financing Agency for Social Entrepreneurship and ClearlySo are leading intermediaries (European Commission, Directorate-General for Employment, Social Affairs and Inclusion, 2019)

Alternative Financing & Support Mechanisms

The below section provides information on the main alternative financial& support mechanisms for startups and social enterprises such as business incubators, accelerators, business angels, and venture capital. Each section elaborates on how these financial and support mechanisms function, what do they offer, differences between them, their role to social enterprises, and some policy recommendations on how to enable and boost these mechanisms in Albania.[1]

Currently, it is drafted the law "For support and development of Innovative Startups" from the Minister of State for Entrepreneurship Protection. The law introduces for the first time concepts such as incubators, accelerators, business angels and venture capital funds at institutional level. This is a first important step, which will probably pave the path for the further development of these mechanisms in Albania.

Business Incubators and Accelerators

What are Business Incubators?

As per the traditional definition of the business incubator, it offers **workspace to entrepreneurs** for a rental fee using preferential terms depending on the industry and the company (OECD, 1999).
The offer usually contains:

- Utilities (i.e., electricity, internet).
- Access to specialized services (i.e., accounting).
- Facilities and equipment, which reduce overhead costs for entrepreneurs.
- Business support services (business planning, organizational & management advice, training, workshops, coaching & mentoring, business development, access to formal and informal networks, legal services). Sometimes these types of services have an additional fee.

There is also the so-called modular approach, which is a program usually followed by incubators that do not provide space. This approach includes combined services considered as needed by entrepreneurs despite the stage of the incubator (European Commission, 2019).

[1]Usually, business incubators, accelerators, venture capital, and business angels function the same either for startups or social enterprises. When the focus is on social enterprises, only the goal differs these structures from the traditional ones.

How do Business Incubators Function?

There are several types of business incubators, which do have different objectives (Halabisky, 2019):

- **Pre-incubators** have a focus on the pre-start-up phase, which offer coaching, business advice, facilities such as equipment, and workspace to support the refinement of business ideas, and development of business plans.
- **Academic incubators** are established by universities and research centers, which provide mentoring to business ideas coming from students or academic staff. Sometimes, these types of incubators are established in collaboration with private firms.
- **General-purpose incubators** provide all the package of services that an incubator can offer ranging from pre to post-incubation phase.
- **Sector-specific incubators** provide the whole set of services to those who have a business idea within a specific sector (i.e., fintech, environment, etc.).
- **Enterprise hotels** specifically offer physical space in areas where it is difficult and costly to rent spaces, as well as provide workshops and networking to the startups, they serve.
- **Corporate incubators** have a special focus on serving to their companies, and their objective is to invest in new start-ups, buy equity, and integrate them into the corporate portfolio.

In general, business incubators offer three stages of incubation (Gerlach & Brem, 2015; European Commission, 2010):

1. **Pre-Incubation phase** consists of two main components a) *pre-entry program* and the b) *selection of tenant entrepreneurs*. The pre-entry program prepares potential entrepreneurs in developing their business ideas and business models to make them ready for the incubator program. Usually, this phase begins with the initial assessment of the business ideas, training on entrepreneurship, and individual coaching. The selection of tenant entrepreneurs is made by a board of experienced managers. Taking into consideration that the success of incubators and accelerators is depended on the performance of selected tenants, they are subject to a scrutinized process, which measures their viability, credibility, and feasibility(Lumpkin & Ireland, 1988, p. 76; Merrfield, 1987, p. 281; Peters, Rice, & Sundararajan, 2004, p. 87).

Within the selection process, there are three phases:

Attractiveness factors//	Fit Factor//	Entry&Growth//
·Sales & Profit potential; ·Political & social constraints; ·Growth potential, ·Competitor analysis; ·Risk distribution; ·Industry structure	·Availability; ·Manufacturing; ·Competence; ·Marketing & distribution, ·Technical support (component and material availability) ·Management	·Choose the method of entry & growth

Source: Adapted from Merrifield (1987)

The selection process consists of a round of pitching to a group of persons who are there to fund the startup if it is worth it (Becker & Gassmann, 2006, pp. 24-25). Aerts et al.(2007, pp. 264-265)underline that the screening process of entrepreneurs is different from one context to another. For example, incubators in the US have a rigid screening process, while in Europe the screening contains simplified guidelines because they do not want to have a false low failure rate.

2 **Main incubation phase** encompasses a set of services ranging from business creation to business growth. These programs do have a batch of milestones to help the entrepreneur reach his goals. Generally, incubators do not pose time limits for this phase, but usually, it lasts **up to four** years. Providing space for tenant entrepreneurs is just one of the services. Other support services are:

- Access to finance.
- Coaching & mentoring.
- Training courses.
- Workshops.
- Networking opportunities

3 **Post-incubation** pertains to the stage when tenant entrepreneurs have matured and will come out of the incubator. This phase happens after 3-5 years when companies have exceeded the space and equipment offered by the incubator. This phase includes workshops, networking, and support related to expansion in the markets and innovating along the way.

In incubators functioning process, there are several important elements (European Commission, 2019):

- *Incubator management sets the incubator's objectives, designs the services, builds& maintains relationships with affiliated organizations, universities and selects tenant entrepreneurs.*
- *Due to being in a community of entrepreneurs, peer learning is one of the main advantages.*
- *Affiliated organizations and institutions are involved in the delivery of support services. Often, incubators are connected with universities and do have benefits due to the opportunity to involve in some processes, students, graduates, and academic staff.*

What are Business Accelerators?

Business accelerators aim to advance the process of business creation and make entrepreneurs ready to obtain capital. Accelerators are a related support structure for entrepreneurs, usually considered as separate from incubators. The main aim of accelerators is the financial sustainability improvement of companies.

The services offered by accelerators Levinsohn (2014) are:

- Seminars in management skills.
- A structured program of business-oriented education.
- Individual coaching and intensive mentoring.
- Involvement of entrepreneurs in their networks with investors, mentors, and customers.
- Preparation for receiving finance in the form of debt or equity. It is important to stress out that not all accelerators provide investment to entrepreneurs.

In general, the services provided by accelerators are tailored to companies' needs. The duration of a business accelerator program usually lasts from three to six months. Business accelerators usually take ownership shares in the companies' part of their programs. Entrepreneurs pass through a more selective process and must have established business ideas that have proven significant results in the market (European Commission, 2019).

How do Business Accelerators function?

At the beginning of the concept, most acceleration programs were funded by venture capital firms (Bone, Allen, & Haley, 2017). Lately, depending on the different missions, accelerators have been established by not-for-profit organizations, corporations, and the public sector. Typically, for-profit accelerator programs provide funding in exchange for equity in the company, usually around 5%-10%. The report of 2016 found that 35.5% of accelerators surveyed were non-profit (Gust, 2016).

The process of functioning as a business accelerator contains a few steps according to Miller & Bound (2011, p. 9):

- The **announcement** for an upcoming accelerator program containing the objective and the registration deadline.
- Usually application process contains an **online form**, which must be filled in by the entrepreneurs.
- The **selection process** comprises several predefined criteria. Generally, the selection process employs interviews with entrepreneurs to clarify various components of their companies. A jury of experts has the task of selecting final entrepreneurs. The process is highly competitive.
- After the selection phase, accelerators begin to provide **their services** to entrepreneurs, both financial and non-financial ones. When the accelerator does not meet the needs of entrepreneurs, they link them with other partners, who can offer the resources required by entrepreneurs(Cohen, 2013; Miller & Bound, 2011). After the cohort selection process, entrepreneurs are involved in intensive training.

Differences between Business Incubators and Accelerators

Often people confuse these two structures with each other. However, it is important to recognize that it is difficult to distinguish these structures in particular with the emerging of virtual incubators that focus only on providing services similar to accelerators(Nchang & Rudnik, 2018). Table 1 presents the main differences between these two structures:

Table 1: Comparison between Incubators and Accelerators

Characteristics	Business Incubators	Business Accelerators
Legal Status	Mostly not for profit	Mostly for profit
Objective	Support business creation and development	Accelerate business growth
Manager Profile	Mostly professionals and academics	Mostly entrepreneurs or business angels
Types of services	• Space provision. • Standard package of services: • Training on entrepreneurship. • Minimal mentoring on the business model and initial business plan. • Access to finance: Grants or seed capital, public funds. • Managerial support (i. e. accounting)	Usually, the services are tailored based on the needs of the company. Seminars: Management skills. Mentoring: Focused on growth strategies. Access to finance: Debt or equity.
Networking	Rarely with investors	With investors and customers
Program duration	3-5 years	3-6 months
Selection of Entrepreneurs	The on-going process and the selection is made according to the criteria set by the incubator, not competitive.	Cohort process, through a competitive selection process.
Scale of Target	Pre-start-up stage (ideas, companies)	After the start-up stage (only companies).
Team focus	Usually no employees; Little experience.	Often 1 or 2 employees; Experienced.
Business Model	Operating costs being largely covered by the rental fees collected.	Associated with private venture capital funds (in the US) or a mix of private and public investors (in Europe).

Source: Adapted from Cohen (2013), Hathaway(2016) Casasnovas & Bruno (2013) Madaleno, Overman, & Waigths (2018), Torun (2016, p. 8)

Despite the differences, incubators and accelerators share some **similarities**. Both structures offer similar services to entrepreneurs, such as the provision or linkage to finance, education, coaching, guidance, and networking (Cohen, 2013, pp. 19-21; Torun, 2016, p. 8).

Role of incubators and accelerators on Social Enterprises

Incubators and Accelerators, which have a specific focus on social enterprises, are relatively new and few compared to business incubators and accelerators since social entrepreneurship is still in the growing phase. However, social incubators and accelerators have paramount importance in education of social enterprises. Often, social enterprises have knowledge neither from the business side nor from the social one. Even in the cases when social enterprises have a certain background, there are still peculiarities to clarify for social enterprises, to make them sustainable (Nchang & Rudnik, 2018).

In terms of **teaching**, the main topics these structures focus on, are: business model, sources of funding, social impact, relationships with various stakeholders, which are more in number compared to conventional enterprises, and public procurement. Teaching SEs the language of social entrepreneurship is another added value of these structures taking into account the multiple stakeholders SEs deal with. On the other hand, investment is very important because the return on investment (ROI) is not the same as in conventional enterprises. Investors (usually called “impact investors”) who are keen on collaborating with social enterprises are more likely to look for social impact returns rather than just profits. Measuring the social impact is as well a crucial theme of teaching from incubators and accelerators (Nchang & Rudnik, 2018).

Incubators provide teaching, coaching, knowledge sharing with other SEs, networking with investors, companies, municipalities, as well as provide spaces as one of their main services.

Policy Recommendations to enable Business Incubators and Accelerators

Even though in Albania there are some ad-hoc programs embodying features of incubators and accelerators, Albania is lagged behind other countries in this regard. Policymakers could introduce several initial policies to enable the path for the emergence or refinement of these structures, in particular those, which have a special focus on social enterprises.

Institutions such as the Ministry of Finance and Economy, the Minister of State for Entrepreneurship Protection and the Ministry for Health and Social Protection which is responsible for the implementation of the law “For Social Enterprises in the Republic of Albania” should take into consideration the option of providing incentives and support for incubators and accelerators. The draft law “For support and

development of Innovative start-ups" mentions the support towards business incubators and accelerators, but it is still not clarified how it will be materialized.

- **First**, the best approach is to support financially either for-profit or not-for-profit entities, which have established an incubator or accelerator, focused on supporting social enterprises. This approach is beneficial because these entities have more knowledge and experience in managing such programs, as well as they are more connected with the relevant communities. Of course, these entities should fulfil several criteria and produce results in terms of stimulating youth entrepreneurship, employment of marginalized groups, and social enterprises, which are making a difference in their communities.
- **Second**, the policymakers could launch public initiatives (incubators & accelerators) with a focus on social enterprises. This approach is a bit questionable since it does not come easy to public institutions to manage programs with an entrepreneurial focus.
- **Third**, it can be a hybrid approach, where the central and local government can offer public, unutilized and accessible spaces to private entities (including non-profit organizations), which could run an incubator or accelerator with the condition to introduce a specific program for social enterprises. Other incentives offered by the local government could include exemption from local taxes for incubators and accelerators serving to social enterprises.
- Taking into considerations the challenges of social enterprises, incubators and accelerators should deliver mentoring and trainings related to business mindset, social impact measurement & reporting, and marketing & sales. In addition, these incubators should provide assistance for potential social enterprises in order to fulfill the criteria required by the legal framework for obtaining the status of social enterprises.

Business Angels and Venture Capital

What are Business Angels?

Business angels (BAs) are individuals encompassing significant business experience who invest their assets into business ideas or startups in the early stages. Investments usually carry high-risk levels, accompanied by high rates of return (Bauer-Leeb & Lundqvist, 2011). BAs enable companies in their early stages to develop products/services and refine their strategies to elevate their offering. Business angels provide to these companies not only financial resources but also their management experience, network, and expertise.

Business angels are in their early stages of development in Central and Eastern European countries. Countries such as the UK, Germany, and France comprise the most developed market in Europe related to business angels (European Commission, Directorate-General for Employment, Social Affairs and Inclusion, 2019).

Based on the data generated by the European Trade Association for Business Angels (EBAN), there are 337,500 investors, which have made 39,990 investments during 2017. The average investment conducted by a business angel is EUR 25,400 (EBAN, 2017).

In terms of sectors, business angels have invested in ICT (32%), biotech & life sciences (10%), and mobile (10%) (European Commission, 2015). According to European Angels Fund (EAF), business angels invest in the ICT sector (65%), life sciences (14%), and 21 % in industries such as manufacturing, services, transportation, and financial sector. Obviously, different sources state that the main sectors remain ICT, biotech and life sciences. Business angels, part of EAF, in general, invest less than EUR 200,000(European Investment Fund, 2020).

Business angel investment dates back to many centuries ago, but nowadays, the concept is thriving not only in the US and Europe but also in other regions. They make investments by becoming more organized and through angel networks (World Business Angels Forum, 2020).

How do business angels' function?

There are two options of investing: a) individually; b) invest as a syndicate (network) where a business angel has a primary role (European Commission, 2017).

Business angels' network is considered as an organization, which makes the intermediary between entrepreneurs and business angels. The number of business angel networks (BAN) is increasing by 17% per year in Europe. Business angels network operate as non-for-profits or private companies. Usually, these are private initiatives, which can be supported by the state to enable investments. Usually, investors do not invest solely, but they join with other business angels and invest in a startup. Business Angels Networks have advantages such as risk distribution, knowledge sharing, and the chance to scale up investment through matching capital resources(European Commission, 2015).

Another form is the co-investment mechanism, which is a public-private partnership arranged between public bodies and business angels to fill a gap in the equity market. These mechanisms lower the financial and political risks (European Commission, 2015).

In general, business angels invest in sectors where they have considerable experience or know-how. Usually, they make decisions based on their contacts, which sometimes makes them follow a localized investment (Harrison, Mason, & Robson, 2010). Researchers have found that business angels prefer to invest in (Kraemer-Eis, 2011; Morrissette, 2007; Berchicci, 2011):

- Companies located near them without sectorial preferences.
- Distant companies that operate in industries familiar to business angels due to their previous investments.

In general, business angels have certain characteristics, such as (European Investment Fund, 2020):

- Invest small amounts of capital.
- Focus on early-stage financing and innovative small & medium enterprises (SMEs).
- BAs usually are hands-on in the companies they invest in.
- Female angels are underrepresented in the ecosystem. Programs focusing on experienced angels indirectly do contribute to the gender gap since do not stimulate women investors.

Business Angel operating model varies from the type of entity, but the investment process encompasses several steps (European Commission, 2015):

- **Search for investment opportunities** from various sources – Business Angel Networks, venture capital funds, investment forums, universities, incubators, platforms, etc.
- **Selection phase** – Selection of companies for review by assessing the business plan, interviewing the team, etc.
- **Pitching Phase** – Entrepreneurs are invited to present their company to business angels during a 15-minute session. Business Angels provide feedback indicating their impression and next steps.
- **Vetting process -** Companies which have passed through the above step go through a diligently screening of every aspect of the business plan, legal aspects, systems, etc.
- **Investment mechanisms-** Business angels choose the type of investment after considering tax incentives and obligations.
- **Negotiations phase**–Business Angels and entrepreneurs sit down and decide about the investment terms, obligations, and responsibilities of each other.

What is Venture Capital?

Venture capital (VC) is a form of equity investment destined for companies, which want to expand, grow rapidly, and access new markets. This type of financing is crucial in particular for innovative companies to thrive in the market (European Commission, 2020).

Venture capital fund is a pool of investment funds, an instrument created to manage the money of investors who seek to purchase shares in promising startups and companies with growth potential. **Venture capital firms** and venture capitalists collect money from high net worth individuals, companies seeking investment, and other venture funds, and manage to invest the pool of money into startups, usually entitled as VC funds' companies (Chen & Scott, 2020). Venture capital firms, as a subset of private equity, charge a higher interest rate to businesses they invest in than traditional lenders due to a higher risk of investment (FundingPost, 2020).There are several associations and unions, such as the National Venture Capital Association (NVCA), which is an organization comprised by several venture capital firms focused on funding innovative enterprises (Chen & Scott, 2020).

Usually, this type of investment can be risky but ensures investors high rates of returns on investment. Startups, which do not own capital or do not have access to bank loans and other debt instruments, find venture capital an essential source of raising capital. Investors obtain ownership shares in the companies they invest capital and consequently have certain decision-making power. Some characteristics of venture capital are (Chen & Scott, 2020):

- High net worth **individuals**, **venture capital firms** provide venture capital to small & medium enterprises and companies in emerging industries.
- Venture capital is provided at **different phases of companies' evolution,** such as seed funding, early-stage, or expansion stage financing. Nonetheless, compared to other private equity firms that tend to invest in more mature companies, venture capital is still focused more on emerging companies seeking core investment.

- Venture capital firms tend to invest in companies with **structured management**, a comprehensive and **well-developed business plan** as well as companies, evidencing explicit facts of potential growth. In addition, venture capitalists are more prone to invest in industries familiar to them or in those; they might have certain expertise.
- In general, venture capitalists have **expertise** in business administration, equity analysts, or competences in a specific industry part of the firm's focus.
- Venture capital firms manage funds coming from a **variety of sources**, such as private and public pension funds, endowment funds, foundations, corporations, and wealthy individuals (Business News Daily, 2020).

According to Invest Europe (2020), venture capital investment **doubled** compared to three years ago, and about 4700 companies were backed with capital in 2019. Investment in startups reached EUR 6 billion comprising 56% of total venture capital. The main sectors, which absorbed from venture capital investment, were ICT (50%), biotech and healthcare (24%), and consumer goods & services (8%).

The main resource VC funds provide is **money**, but they help the startups/companies by giving advice, transferring knowledge, provide contacts from their network, improve their skills with employees, and bookkeeping. Credible VCs improve the image of the companies they invest in as well as enhance their productivity by putting pressure on them to achieve the results forecasted (Stuart, 2013).

How does venture capital function?

There are several steps for companies, which are seeking for venture capital (Chen & Scott, 2020):

- First, startups or companies have to submit a **well-developed business plan** to a venture capital firm or an investor.
- When the venture capital firm or the investor finds the applicant of interest, they conduct a **diligent investigation** in terms of business model, products/services, systems, management, operation, and history.
- After the due diligence, the venture capital firm will **pledge the capital** in exchange for equity shares in the company. The funds may be disbursed in both ways, all at once, or disbursed in several rounds.
- Then the firm or investor takes **a pro-active role** in the funded company, coaching and monitoring the progress of the company through a set of indicators before disbursing additional funds.
- The venture capital firm **exits** the company typically after 4-6 years the first investment has been made, by initiating a merger, acquisition, or public offering.

Venture capital firms have a specific investment profile. The profile entails the type of businesses the firm is focused on investing (FundingPost, 2020).

Usually, the structure of a VC firm is composed of (Bacior, 2019):

- **General partners** – people in charge of managing the VC fund and the relations between limited partners and the firm, as well as are responsible for making the decisions about the investments.
- **Limited partners** – individuals, companies, organizations, who provide the funds' investments.
- **Venture partners-** report to general partners and run the operations within the firm, such as conducting the whole process of finding startups and companies and work with them to meet the goals.
- **Principals** work under partners to help partners close the deals and often work directly with funded companies on particular issues and operational tasks.
- **Associates** work under principles on the ground to perform financial analysis, assessments, contract reviews, and assistance in deal sourcing and management of funds.

The business model of venture capital firms is based on management fees and carried interest. Management fees are calculated based on a percentage of the capital pooled in the fund, typically 2-2.5 %. Carried interest is a share of the profits paid to venture capital firms when the investments result successfully. Carried interest is usually 20-25% of the profits, out of which 20% belong to general partners and 80% to limited partners (Startupxplore, 2017).

Differences between Business angels and Venture capitalists

Besides the fact that both are equity financing forms, which share similarities, BAs and VCs have certain differences:

Table 2: Comparison between business angels and venture capital

Characteristics	Business Angels	Venture Capitalists
Profile	Wealthy individuals (or groups of wealthy individuals)	Employees of venture capital firms
Source of funding	Invest their own money	Invest other's people money (individuals, companies, foundations, other equity firms, etc.)
Amount of investment	Usually small amounts	Large amounts
Timeframe of the deals	Flexible (but usually the deal is closed up to 1 month)	Fixed timeframes (but usually the deal is closed from 3-6 month)
Uncertainty	Fixed along the way	Much research
Finding startups/companies	Networks they belong	Own Research
Method of control	Personal pressure	Strict contacts
Stage focus	Invest mostly in the seed stage of the company	Invest in the seed stage, early-stage, or expansion stage
Geography	Local	Not bound to specific regions
Industries	Invest in various industries they are familiar with	Invest in specific industries mostly focused on technology
Criteria focus	Entrepreneur characteristics	Hard facts of the company/startup
Role in the business	More a mentor role	A seat on the board (More controlling role)
Communication	Rather informal	Regular reports
Length of investment	Usually after 3-5 years	Usually up to 10 years
Available data	Scarce data compared to VCs since it is difficult to identify private, individual investors in unquoted companies.	Official and relevant data

Adapted from European Investment Fund (2020), Startups.com (2019), OECD (2011), Mason & Stark (2004), (Dao, 2019), (Gouchev Law), (De Vries, 2015).

In terms of similarities, both business angels and venture capital funds are **private equity** forms of investments, which invest money in exchange for ownership shares. Besides the capital, BAs and VCs advise the companies they invest in and provide them a large **network** (De Vries, 2015). Likewise, VCs, business angels invest in a **portfolio** of companies and do not make only one or two investments(World Business Angels Forum, 2020). **Uncertainty** in terms of return on investment is a similar characteristic because the investment is made in unquoted companies, at the early stages of development, which are producing novel products/services for the market (European Commission, 2017).

Role of Business Angels and Venture Capital on Social Enterprises

There are very few business angels investing in social enterprises. Even though business angels want to see facts and numbers in a business plan, when it comes to social enterprises, they focus mostly on the **qualities of social entrepreneurs**. In such cases, the investment goal of business angels is closely focused on the social return rather than financial return (PWC, 2014).

The relation between business angels and social entrepreneurs is fundamentally based on **trust**. Besides qualities such as solidarity, cooperation, altruism that a social entrepreneur should have, business angels, look for entrepreneurial qualities too such as drive, passion, competitiveness, business mindset. Reaching an agreement between a business angel and a social entrepreneur is a milestone since there are many factors hindering the chances of investments. They have to agree on various terms such as the social & environmental impact, the level of return on investment, and methods to measure the social impact (Bauer-Leeb & Lundqvist, 2011).

Social venture capital funds have been arising in recent years in Europe. **Social venture capital** comprises a philanthropic form of investing due to its focus on finding social impact companies. **Social venture capitalists** do not require only social impact but also financial return on investment. While traditional venture capitalists chase the maximization of the financial return on investment, social venture capitalists seek the maximization of both financial and social returns. Social venture capital firms, funds, and impact investors offer social venture capital. The focus of social venture capital firms is mostly oriented to companies operating in developing countries (Luenendonk, 2018).

Social venture capital firms assess the **commitment** of social entrepreneurs and their teams to their mission as well as expect from them to measure their impact (PWC, 2014). Another significant variable taken into consideration by social venture capitalists is the emotional **attachment to the cause** when it comes to investing in social enterprises (Bocken, 2015). In general, social venture capital funds commit to long-term funding to help social enterprises grow and become financially sustainable (Scarlata, Gil, & Zacharakis, 2012).

In terms of operational model, social venture capital firms apply the model of traditional venture capital (European Commission, Directorate-General for Employment, Social Affairs and Inclusion, 2019). Currently,

there are **11 funds[2]** registered as European Social Entrepreneurship funds in Europe in six countries in Europe (European Securities and Markets Authority, 2019)

Policy Recommendations related to Business Angels and Venture Capital

In terms of policies and practical environment, business angels and venture capital constitute an utterly unexplored form of financing for the Albanian ecosystem.

The first policy recommendations address social enterprises and other actors in the ecosystem to start raise awareness and build capacities with regard to these financial mechanisms.

- First, the **increase of awareness and knowledge** on these types of financing forms should be provided in universities, through formal and informal training to potential and existent entrepreneurs as well as for supporting organizations part of the ecosystem. The training curricula and the workshops should tackle BAs and VCs as two particular mechanisms from which startups and SEs in Albania might get investment.
- Young social entrepreneurs should start thinking creatively and generate ideas in ICT, life sciences, fintech which are **growing industries** with a huge potential to get investment from BAs and VCs. They should not focus only on traditional sectors where existing SEs operate such as artisan products which tend to be less scalable and less prone to get investment.

The following set of policy recommendations addresses policymakers and responsible institutions such as the Ministry of Finance and Economy and the Ministry for Health and Social Protection to start taking into account the introduction of certain incentives for these types of investors in order to stimulate their investment appetite towards Albanian startups and SEs. In Europe, 13 countries provide in total 46 tax incentives, out of which France and the United Kingdom have the most sophisticated schemes. Based on the European best practices, there are some policy options used to create a conducive environment for business angels and venture capital to flourish (European Commission, 2017):

- Introduction of policies aiming to address risk aversion, which is very high for VCs and BAs, such as the provision of **upfront tax credits** for investments in startups and social enterprises.
- Tax incentive design should target investments in **specific industries** crucial for the development of the country such as ICT, fintech, tourism, agriculture, and social innovation.
- Provision of **tax reliefs or tax exemption on future return on investment** are considered as very important because it can make BAs and VCs less risk-averse to invest in startups, which might not have any income in the early stages (Gentry & Hubbard, 2000; Keuschnigg & Nielsen, 2004).
- Another policy option is the stimulation of VC funds and BA investment by establishing **governmental sponsored VC funds** or **co-investment schemes**, where the state is a contributor. These schemes should focus on specific industries of importance for socio-economic development, and, in social enterprises, which bring a social impact in their communities. To be noted is that too much direct investment activity from the government has its pitfalls of ending up supporting politically privileged projects. Thus, these types of funds must have specific restrictions (Social Innovation Europe, 2020).
- Revision of the law No.65/2016 “For Social Enterprises in the Republic of Albania” for the restrictions such as the profit distribution aiming to enable these mechanisms to invest to social enterprises in Albania.

[2] The funds are Big Issue Invest Social Enterprise Investment Fund II LP (United Kingdom), Big Issue Invest Outcomes Investment Fund L.P. (United Kingdom), BIG ISSUE INVEST OUTCOMES INVESTMENT FUND L.P (France), BonVenture III GmbH & Co. KG (Germany), MRI-Pilotfonds GmbH & Co. KG (Germany), BonVenture II GmbH & Co. KG (Germany), CREAS IMPACTO, FESE, S.A. (Spain), Epiqus Työhyvinvointi I Ky (Finland), Epiqus Kotouttaminen I Ky (Finland), PHITRUST PARTENAIRES (2014, France), Pymwymic Impact Investing Coöperatief U.A. (Netherlands)

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