

# HOW DO PHILANTHROPIC VENTURE CAPITALISTS CHOOSE THEIR PORTFOLIO COMPANIES?

Mariarosa Scarlata, ESADE Business School - URL, Spain (\*)  
Luisa Alemany, ESADE Business School - URL, Spain

## ABSTRACT

*This paper examines the deal origination and the selection process adopted by philanthropic venture capitalists when deciding which social organizations to include in the portfolio they manage. The origination and screening practices as well as the selection variables explicitly considered by philanthropic venture capitalists are then compared to those taken into account by traditional for-profit venture capitalists to understand whether or not the behaviour of the two investor categories is the same. The research is based on a sample representing 54% of the European and US population of philanthropic venture capitalists. Philanthropic venture capitalists appear to originate and select deals like traditional venture capitalists. However, they also adopt different deal origination criteria which are not traditionally used by venture capitalists, i.e., incubation and direct creation of an organization in the event of not finding a suitable organization. Furthermore, selection variables such as “deal terms” and “technology” are not considered to be as important as in the case of venture capital.*

Keywords: Venture philanthropy, venture capital, social entrepreneurship.

Codes: 800-810.

## INTRODUCTION

In recent years, philanthropic venture capital (PhVC), also known as venture philanthropy, has developed as a new financing model for social entrepreneurship. First presented by Letts, Ryan, and Grossmann in 1997, PhVC is the application of venture capital (VC) strategies and techniques to the financing of social enterprises (SE). As such, PhVC is an intermediate investment in small-medium SE with potentially high social impact .

Like their for-profit counterparts, i.e., the venture capitalists (VCs), philanthropic venture capitalists (PhVCs) have developed specialized abilities when selecting entrepreneurial projects. However, while VCs select deals in terms of creation and maximization of shareholder value (Amit *et al.*, 1998), PhVCs engage in a partnership with SE with the explicit purpose of maximizing social impact. Due to PhVCs' philosophy of high engagement, a limited number of SE receive PhVC funding after a rigorous selection and due diligence process.

Despite the growing interest in PhVC, from both professional and academic circles, so far, no study has investigated the selection process of PhVC investments. More specifically,

---

\* Contact author: Mariarosa Scarlata; ESADE Business School - URL, Barcelona, Spain; (T) +34625991409; [mariarosa.scarlata@esade.edu](mailto:mariarosa.scarlata@esade.edu)

The authors would like to thank the ESADE Institute for Social Innovation for their help and financial support towards this research.

there is no transparency in terms of deal origination sources used by PhVCs and the variables that are explicitly considered in the screening process. Furthermore, considering that the PhVC approach stems from the for-profit VC model, the issue of the relationship between the PhVC and VC selection process has not yet been investigated.

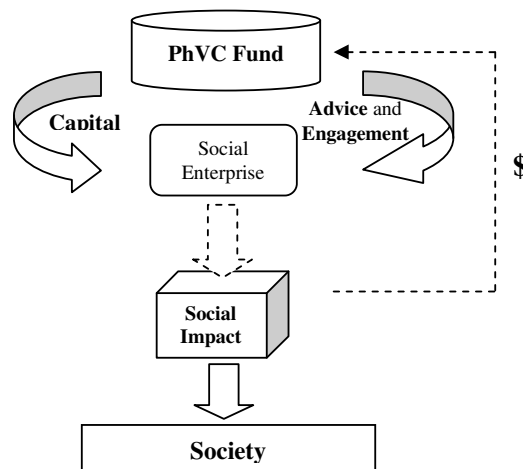
The aim of this paper is twofold. First, to identify the deal origination and deal selection criteria of PhVC investments. Second, we then compare the identified variables and approaches with those characterizing the traditional VC model. Additionally, the issue of the existence of differences in the selection process between US and European entities is investigated. The analysis is based on a web survey which was sent to the entire population of PhVCs both in Europe and in the US.

The subsequent sections of the paper are structured as follows. First, the paper reviews the PhVC concept and the approach adopted by traditional VCs in their deal origination and deal screening phases. With respect to the deal origination phase, passive and proactive criteria adopted by VCs are identified; concerning the deal screening phase, the dimensions and variables taken into account by VCs are listed. Second, methodological issues are discussed and a description of the PhVCs population and sample is presented. Third, the analysis of the results obtained from the survey are discussed. Lastly, the paper presents conclusions and research opportunities.

## CONCEPTUAL ISSUES

PhVC, also known as venture philanthropy, is a relatively new concept. Scholars in the VC and philanthropic field have just begun to investigate it on a systematic basis. Back in 1997, Letts, Ryan, and Grossman presented the concept of PhVC as the transposition of the practices adopted by VCs to traditional forms of philanthropy. Stemming from the definition of the traditional for-profit VC, but taking into account the main and explicit social purpose of the PhVC concept, Scarlata and Alemany (2008) define PhVC as an intermediated investment in small-medium SE with potentially high social impact. Financial return considerations may, however, also be taken into account. The PhVC model is depicted in Figure 1. While traditional forms of philanthropic financing tend to address one particular project or program, the PhVC approach aims at supporting the SE's organizational capacity. Thanks to this particular support the long-term survival of the latter is expected to be ensured.

**Figure 1:** The PhVC model.



**Source:** Scarlata and Alemany (2008).

Although the PhVC concept has developed out of the traditional profit maximizing VC model, i.e., investing in innovative and potentially financially profitable ventures, the value proposition of the PhVC models is indeed quite different from those of VCs. Rather than focusing on financial return maximization, PhVCs back primarily those SE which adopt innovative approaches to address urgent and overlooked social problems. As a result, PhVCs aim at maximizing social impact. However, differently from the approach adopted by traditional project-oriented philanthropists but like traditional VCs, PhVCs hold a small portfolio of SE to which capital and strategic advice is provided. The basic assumption is that choosing recipients and allocating funds is itself a source of social value creation (Porter and Kramer, 1999).

The question arising from the discussion presented here consists of understanding whether it is possible for PhVCs to have a deal origination, screening and evaluation that closely parallels the behaviour of traditional VCs, especially considering the divergent value proposition of the two. Early studies on VC by Tyebjee and Bruno (1984), as well as Sweeting (1991), show that potential deals are brought to the attention of VCs either through a passive or proactive search. Passively, VCs either receive unsolicited proposals from entrepreneurs, or through a referral process. Tyebjee and Bruno (1984), based on observations made in the period early to mid-1980s, find that unsolicited proposals from the entrepreneur typically generate from cold calls and the usual response from the VCs is to request a business plan to be sent. Referrals generally originate from a syndication process with referring VCs acting as lead investors and seeking the participation of other VC funds. Sweeting (1991) also shows that referrals come from intermediaries (e.g., accountants), prior or existing investees and personal acquaintance.

Proactively, Sweeting (1991) reports that VCs tend to search new deals through their network. However, Tyebjee and Bruno (1984) conclude that proactive behaviour by VCs in seeking out deals was not a widely adopted means of deal origination. The most popular approach was to wait passively for deal proposals to be put to them. On the other hand, Sweeting (1991) shows that VCs became more proactive in the origination phase of their investments. Table 1 summarizes the dimensions and the variables taken into account by traditional VCs, either in passive or proactive.

**TABLE 1:** Criteria used by traditional VCs to originate deals.

<i>Dimensions</i>	<i>Variables</i>
<b>Passive criteria</b> <i>I. Source: Entrepreneur</i> <i>II. Source: Referrals</i>	Business network
<b>Proactive criteria</b> <i>I. Source: Referrals</i>	Network of parent organizations, i.e., venture capitalists Organizations in the existing PhVCs portfolio Proactive contact of other entities

Source: Elaboration by the authors based on Tyebjee and Bruno (1984), and Sweeting (1991).

Recent studies on PhVC (cf. Meyskens and Post, 2007; Van Slyke and Newman, 2006) focus on the use of the PhVC approach in defining social entrepreneurship and the links between the two. To our knowledge, no study on the deal origination exists. Considering the above discussion, we expect that the PhVC deal origination phase follows that employed by traditional VCs. Moreover, considering that the PhVC movement first emerged in the US, a test for equality of methods adopted by US and European PhVCs fund is conducted. As a result, Hypothesis 1a and 1b are the following:

**Hypothesis 1a:** *Philanthropic venture capitalists originate deals either passively or proactively. If passive, philanthropic venture capitalists search for new potential deals through the social entrepreneur or referrals; if proactive, philanthropic venture capitalists contact other entities.*

**Hypothesis 1b:** *European and US philanthropic venture capitalists employ the same passive and proactive criteria in originating deals.*

Concerning the deal-screening phase, previous studies on the VC approach show that typical VC organizations select investments by taking into account four main dimensions: entrepreneurial: organizational activity; deal terms; and external environment. At the entrepreneurial level, MacMillan, Siegel, and Narasimha (1985), as well as Smart (1999), suggest measuring the “entrepreneur” dimension through variables such as personality and experience in the VC-screening phase. At the organizational activity level, MacMillan *et al.* (1985) and Kaplan and Stromberg (2000) show that business strategy, product or service, technology, and customer adoption are considered key to VCs. Also, Tyebjee and Bruno (1984) find that the geographic location of the venture is used as a screening criterion due to an effort to maintain travel time and expenses at a manageable level. On the other hand, Rea (2002), Kaplan and Stromberg (2000), Quindlen (2000), and Bygrave and Timmons (1992) report that low valuation or attractive contractual structure as well as the fit of the new investment in the VCs’ portfolio play a significant role. In this respect, Mac Millan *et al.* (1985) suggest that also financial considerations, e.g., expected required rate of return, should be taken into account in the screening and selection phase of VC investments. Table 2 summarizes the dimensions and the criteria taken into account by traditional VCs in their selection process.

**TABLE 2:** Dimension and criteria used by traditional VCs to select deals.

<i>Dimensions</i>	<i>Variables</i>
<i>I. Entrepreneur and management</i>	Personality Experience
<i>II. Activity of the enterprise</i>	Business strategy Product Technology Customer adoption Location
<i>III. External environment</i>	Market size
<i>IV. Assessment of the deal</i>	Fit in the VCs portfolio Deal terms
<i>V. Potential</i>	Potential expected financial return

Source: Elaboration by the authors based on Tyebjee and Bruno (1984), and Sweeting (1991).

To our knowledge, no study exists on the deal-screening phase of PhVC investments. As the PhVC approach stems from the practices adopted by traditional VCs, the above discussion leads to Hypotheses 2a and 2b:

**Hypothesis 2a:** *Philanthropic venture capitalists use the same screening and selection dimensions as those used by traditional venture capitalists.*

**Hypothesis 2b:** *Philanthropic venture capitalists use the same screening and selection criteria as those used by traditional venture capitalists.*

As previously done for deal origination criteria, we also test for equality of screening variables adopted by European and US PhVC funds. As such, Hypothesis 2c is the following:

**Hypothesis 2c:** *European and US philanthropic venture capitalists consider the same screening selection dimensions and variables.*

## **METHODOLOGY**

During the spring of 2008 seven PhVCs in Europe and in the US were face-to-face or telephone interviewed in order to establish how deals are originated and what variables they use when evaluating new venture proposals. The results from the in-depth interviews were used to assemble a web-based questionnaire which was sent to the entire population of 74 PhVC funds both in Europe and in the US. The PhVC population was identified by mainly consulting two databases: the European Venture Philanthropy (EVPA) directory (EVPA, 2008) in the case of Europe, and the National Venture Capital Association (NVCA) web page on venture philanthropy (NVCA, 2008) in the case of the US. Other sources were also consulted. First, the NVCA list was combined with a report by the Morino Institute (2001). Second, the EVPA list was made up of a list of PhVC organizations reported by John (2006). Lastly, other PhVC active in the field were identified by skimming through the members of the board of directors of the previously identified PhVCs.

Overall, 74 PhVC funds were identified: 38 in Europe and 36 in the US. We first e-mailed the web-survey to all of them. Then, we sent a fax and email to those funds that did not respond to the web version. Overall, 40 responses were received. This result corresponds to a 54% response rate. The high response rate indicates a high level of interest in the research. For non-respondents, the dominant reason for refusing to participate in the research survey was the confidentiality of the information requested. A second reason cited by PhVCs was their heavy schedule and limited resources.

A description of the population and of the sample is presented in the Appendixes. Appendix 1 classifies PhVCs according to the legal structure. Accordingly, 40.5% of the PhVCs population takes the public charity legal structure, while 28.4% are foundations. In 10 cases (13.5% of the population) the identification of the legal form of the PhVC fund was not possible due to a lack of publicly available information. In terms of sample, PhVC funds result to be mainly foundations (40% of the sample) and public charities (20% of the sample). If comparing the population with the sample, 76.2% of foundation PhVCs and only 26.7% of public charity PhVCs responded to the survey. From the responses obtained, only marginally the PhVCs sample take the form of a donor advised fund (10%), trust (2.5%), and other legal structures. The latter is related to the non-profit segment, including those PhVC funds that are community foundations, funds that are both public charity- and donor-designated funds, and private charitable companies.

In terms of nationality, 51.4% of the PhVCs population is European, 48.6% from the US. Within Europe, PhVCs are mainly located in Continental Europe (27.03% of the population) and in the UK (20.3% of the population). Only 4.05% of PhVCs are active in Eastern Europe. The same pattern is found in the sample: 55% of the sample belongs to Europe vs. 45% to the US. Within Europe, 32.5% of PhVCs are from Continental Europe, 20% from UK, and 2.5% from Eastern Europe respectively (cfr. Appendix 2).

Appendix 3 shows PhVCs by year of foundation. The majority of the population funds are relatively young: 56.6% were created in the time period 2000-2008, after that the dot.com

bubble started to explode and considerable wealth had already been created. The sample follows the same behaviour: 70% were created in the above mentioned period of time.

To grasp how much money is involved in the PhVC sector, respondents were asked to report their “Assets under management” (AUM). From the responses obtained, the categories presented in Appendix 4 were created. Some 22.5% of funds manage assets between five and ten million US dollars. Overall, 27 funds (75% of respondents, excluding missing AUMs) fall into the category of AUM up to twenty million US dollars. Among the remaining funds (25% of respondents), only one PhVC manages funds of more than one billion US dollars. Respondents were also asked to provide the minimum and the maximum amount of money they usually provide to the SE that they back. On average, the minimum amount is 135 thousand US dollars, with a lower limit of 4.1 thousand and an upper limit of 1 million. As the maximum amount, PhVCs provide on average 1 million US dollars, with a lower limit of 25 thousand and an upper limit of 10 billion. To this respect, one respondent claimed to have no pre-established minimum amount to be provided, while two have neither a minimum nor a maximum amount. Given the high number of PhVC funds which miss data on their AUM (for 40.5% of the PhVCs population no information is publicly available), no consistent conclusions can be inferred in the case of the population.

## **RESULTS**

This section of the paper presents the results obtained from the survey. It is divided into three parts. First, the deal origination criteria are discussed. Second, the selection variables are analyzed. Last, data on control variables taken into account by PhVCs in their screening model are presented.

### **a. Deal origination**

Five criteria of passive and six criteria of proactive deal origination were identified, collated, and assembled in Table 3 and Table 4. In order to classify the criteria used by PhVCs, the criteria adopted by traditional VCs according to the literature are transposed here. Passive criteria are accordingly classified into two main groups, with proactive criteria being classified into three groups.

Table 3 reports the percentage of PhVCs using passive criteria. Group 1 and 2 were identified according to the VC literature. Group 1 deals with those criteria used by PhVCs in receiving unsolicited proposals directly from the social entrepreneur; group 2 deals with passively received referrals. Group 3 was identified based on the pilot interviews with leading PhVCs. It includes those PhVCs that do not accept unsolicited proposals at all. Group 4 contains other methods suggested by respondents PhVCs and used by these to receive applications. In the questionnaire, PhVCs were asked to select the methods they adopt to receive unsolicited proposals: if a method is used, the information is coded as 1; otherwise this value is 0.

Table 4 presents results concerning proactive methods. According to the VC literature, group 1 – referrals – was identified. Again, the remaining groups were identified from the in-depth pilot interviews. In particular, group 2 includes the creation of a social enterprise by the PhVC fund; group 3 includes other methods of proactive search.

The results presented in Table 3 and Table 4 enable us to make the following observations. Like traditional VCs, in 90% of the cases PhVCs receive unsolicited proposals directly from the social entrepreneur, who applies for funds either via the PhVC’s web page (52.5% of PhVCs prefer this method of receiving proposals) or by formally sending the application to the PhVC’s offices (37.5% of PhVCs receive applications by mail). On the

other hand, the referral method from the PhVC business network is used by 40% of the surveyed PhVCs. Surprisingly, 25% of PhVCs declare that unsolicited proposals are not accepted, indicating that these mainly seek new potential investments proactively. In the survey, PhVCs were also asked to indicate additional employed passive methods not proposed in the survey. Only two PhVCs listed other methods, confirming that PhVCs mainly adopt the previously mentioned methods. Both these PhVCs use public announcements or conferences to get to know about potential deals. It is worthy to clarify that PhVCs were allowed to select multiple options in the survey: this is the motivation of not having a 100% sum both in Table 3 and Table 4.

**TABLE 3:** Percentage of PhVCs using passive deal origination criteria.

	<i>% of PhVCs</i>	<i>Median</i>	<i>SD</i>
<b>Passive criteria</b>			
<i>I. Source: social entrepreneur</i>			
A. Specific section on the PhVCs web page	0.525	1	0.51
B. Social enterprises send proposals to the PhVCs offices	0.375	0.0	0.49
<i>II. Source: Referrals</i>			
C. Business network	0.4	0.0	0.50
<i>III. Unsolicited proposals are not accepted</i>			
	0.25	0.0	0.44
<i>IV. Other</i>			
	0.075	0.0	0.35
<i>IV. Do not know</i>			
	0.025	0.0	0.16

Sample size: 40. Multiple choice question.

Proactively, PhVCs tend to use a referral network approach in their search for new SE to support (cfr. Table 4). On average, 95% of PhVCs proactively seek out new deals either by contacting their own network of philanthropists or through other entities. Given the very low standard deviation of the two search channels, it is clear that almost every PhVC uses these methods. Surprisingly, 50% of PhVCs incubate SE to test its suitability in the fund's social strategy. Even though 42.5% of PhVCs chose the creation of an ad-hoc SE in the event of no suitable SE being found, the standard deviation of this category is the highest in the proposed options. PhVCs also mentioned other proactive search methods to those explicitly proposed in the survey. From the comments added by PhVCs in the questionnaire, two indicated that proactive search is done through own research, one through conferences, one through a network of public agencies, and one through consultants. Results showed that these methods are used only marginally by PhVCs.

**TABLE 4:** Percentage of PhVCs using proactive deal origination criteria.

	<i>Mean</i>	<i>Median</i>	<i>SD</i>
<b>Proactive criteria</b>			
<i>I. Source: Referrals</i>			
A. Network of philanthropic supporters	0.95	1	0.22
B. Network of venture capitalists contacts	0.78	1	0.42
C. Organizations in the existing PhVCs portfolio	0.93	1	0.27
D. Proactive contact of other entities	0.95	1	0.22
<i>II. Source: Creation of a social enterprise</i>			
E. Incubation	0.5	0.5	0.51
F. Direct creation of a social enterprise in the event of not finding a suitable candidate	0.43	0.0	0.50
<i>III. Other</i>			
	0.28	0.0	0.45

Sample size: 40. Multiple choice question .

Concerning the proactive methods for deal origination, PhVCs were then asked to rate each method using a 1-7 rating scale. Results are presented in Table 5. The channel most used by PhVCs while seeking new deals is referrals through proactive contact with third parties (score of 5.3 points). Besides being the most frequently used, the method is also characterized by the lowest standard deviation in the proposed options. This indicates that this channel is widely used by PhVCs, and moreover confirms the result presented in Table 8. Within the referrals dimension, another important source of deal origination is the PhVCs network of philanthropic supporters, which receives a rating close to 5. By their intrinsic nature, this criterion is not among those used by traditional VCs and this is due to tautology.

**TABLE 5:** Rating assigned by PhVCs to proactive deal origination criteria.

	<i>Mean</i>	<i>Median</i>	<i>SD</i>
<i>I. Referrals</i>			
D. Proactive contact of other entities	5.3	6	1.45
A. Network of philanthropic supporters	4.95	5	1.62
C. Organizations in the existing PhVCs portfolio	4.6	5	1.69
B. Network of venture capitalists contacts	3.25	3	1.86
<i>II. Creation of a social enterprise</i>			
E. Incubation	2.58	2,58	1.74
F. Direct creation of a social enterprise in the event of not finding a suitable candidate	2.30	1	1.85
<i>III. Other</i>			
	2.8	1	2.39

Sample size: 40; scale: 1-7, where 1 = Never used, 3 = Sometimes, 7 = Always.

By taking a closer look at this criterion, we would expected this to occur mainly for those PhVCs undertaking a non-profit related legal form. The reason lies in the fact that traditionally non-profits result to be more related to the legal structure of traditional philanthropists. However, this is not the case. If PhVCs are classified into two main legal structures, i.e., non-profit and for-profit, 82.5% of the surveyed PhVCs take the non-profit form, 17.5% the for-profit one (cfr. Appendix 1). Now, combining these structures with the use of the philanthropic network, almost 97% of those non-profit PhVCs use it to generate new potential deals, and 85.7% of the for-profit ones does it as well (cf. Table 6). We interpret this result as a signal that PhVCs have developed a network with philanthropic supporters, independently from the legal structure PhVCs take.

**TABLE 6:** Deal origination: number of PhVCs and combination of the PhVCs legal structure and use of network of philanthropists to originate deals.

	<i>Frequency</i>	<i>% over total number</i>
Foundation	16	100%
Public charity	8	100%
Donor-advised fund	4	100%
Trust	1	100%
Other	3	75%
<i>Total non-profit</i>	32	96.9%
For-profit	6	85.7%

Previous results are also confirmed by Spearman's correlation coefficient, as reported in Table 7. As a methodological issue, it is worthwhile clarifying that Spearman's correlation coefficient was calculated given that the collected data proved not to present a normal



distribution. Consequently, on the one hand, this made it impossible to use both the standard Pearson’s correlation coefficient and the linear regression model. On the other hand, a non-parametric test must be considered.

Like traditional VCs, PhVCs proactively use the organizations already in their portfolio to originate new deals. While traditional VCs have not developed a network with philanthropists, PhVCs have developed such a network with their for-profit counterparts. From the results reported, 78% of the surveyed PhVCs use the contacts in the VCs community to find new deals. However, the use of this channel is rated 3.25, with a standard deviation higher than that of other proposed options, indicating that there is no consensus on the use of this method. Incubation and direct creation of SE are seldom used, confirming the results in Table 4.

**TABLE 7:** Spearman’s correlation coefficient (rho) between “Legal structure” and “Deal origination through network of philanthropic supporters” (A).

		<i>Legal form</i>	<i>A</i>
<i>Legal form</i>	Correlation coefficient	1	
	Sig. (2-tailed)	-	
<i>A</i>	Correlation coefficient	-0.062	1
	Sig. (2-tailed)	0.703*	-

\*95% confidence interval.

Table 8 shows the results of the analysis of proactive methods of deal origination using Kendall’s W, which is interpreted as a coefficient of agreement among respondents. More specifically, Kendall’s W is a normalization of the Friedman test to vary from 0 to 1, with 1 indicating complete inter-rater agreement, and 0 indicating complete disagreement among raters. Results of Kendall’s statistics show that inter-rater agreement concerning proactive methods of deal origination is quite low. However, the result is not statistically significant. We interpret this as a confirmation of the results obtained in terms of standard deviation.

**TABLE 8:** Kendall’s W statistics for proactive methods of deal origination.

Kendall's W	0,41
Chi-square	98.03
df	6
Asymp. Sig.	0.00

Considering the criteria of deal origination by PhVCs, mentioned above, and taking into account the social environment in which PhVCs operate, we find evidence that the same sources used by traditional VCs are employed. Although rarely used, an additional dimensional source, which is not found in the traditional VCs literature, is identified among the proactive criteria used by PhVCs, i.e., creation of a SE either through incubation of already existing SE or through direct constitution.

The results concerning Hypothesis 1b are reported in Table 9 and Table 10, which show the non-parametric Mann-Witney U test for equality of methods used by European and US PhVC funds. We fail to reject the hypothesis that both European and US PhVCs use the same criteria to originate deals and that these are rated differently.

In order to apply for support, SE are required to provide the PhVC investor with a series of documents. Table 11 presents the number of PhVCs requiring formal information from the SE. To this respect, PhVCs were allowed to select multiple categories of information. Table 12 shows the importance rating given to each piece of information by the PhVCs, while Table 13 presents results related to those documents rated as “Very important” by PhVCs.

Table 14 shows results related to Kendall's W coefficient of agreement. According to the sample, and in the same way as VCs, PhVCs rate the business plan as the most important document for considering an application. It is required by 97% of PhVCs, and besides receiving an average rating higher than 6, 55% of the respondents declared it to be a very important document to receive. Although a high number of PhVCs consider "explanation of what the funds will be used to accomplish" and "estimation of needed capital" as selection variables and rate their importance above 5, respectively only 30% and 22.5% of the respondents consider these to be very important. In the "Other" category, documents such as letter of interest, the SE's charter, the forecasted exit strategy, explanation of how the SE intends to work with the PhVCs have been mentioned by 15% of the respondents. However, the high standard deviation – compared to the other listed documents – indicates that these are not widely required.

**TABLE 9:** Test for equality of use of passive criteria of deal origination in Europe and US<sup>†</sup>.

	<i>I. Source: social entrepreneur</i>	<i>II. Source: Referrals</i>	<i>III. Unsolicited proposals are not accepted</i>	<i>IV. Other</i>	
	<b>A</b>	<b>B</b>	<b>C</b>	<b>D</b>	
Mann-Whitney U	176.0	183.0	163.5	168.0	173.0
Wilcoxon W	429.0	354.0	316.5	421.0	344.0
Z	-0.694	-0.486	-0.231	-1.087	-1.186
Asymp. Sig. (2-tailed)	0.488	0.627	0.817	0.277	0.236

**TABLE 10:** Test for equality of use of proactive criteria of deal origination in Europe and US<sup>†</sup>.

	<i>I. Referrals</i>				<i>II. Creation of a social enterprise</i>	<i>III. Other</i>	
<i>Use – Proactive criteria</i>	<b>A</b>	<b>B</b>	<b>C</b>	<b>D</b>	<b>E</b>	<b>F</b>	
Mann-Whitney U	196.0	197.0	191.0	196.0	198.0	185.0	159.0
Wilcoxon W	367.0	450.0	444.0	367.0	369.0	356.0	330.0
Z	-0.144	-0.038	-0.417	-0.144	0.0	-0.413	-1.371
Asymp. Sig. (2-tailed)	0.886	0.970	0.677	0.886	1.0	0.680	0.171
<i>Rating – Proactive criteria</i>							
Mann-Whitney U	196.0	197.0	191.0	196.0	198.0	185.0	159.0
Wilcoxon W	367.0	450.0	444.0	367.0	369.0	356.0	330.0
Z	-0.144	-0.038	-0.417	-0.144	0.0	-0.413	-1.371
Asymp. Sig. (2-tailed)	0.886	0.970	0.677	0.886	1.0	0.680	0.171

<sup>†</sup> Grouping Variable: Nationality; Level of significance: 95%.

**TABLE 11:** Percentage of PhVCs requiring information.

	Business Plan	Estimation of needed capital	Explanation of what the funds will be used to accomplish	Financial plan	Turnover	Audited accounts	Other
Mean	0.9744	0.9744	0.9737	0.9730	0.9375	0.9118	0.5652
Median	1	1	1	1	1	1	1
SD	0.1601	0.1601	0.1622	0.1644	0.2459	0.2879	0.5069

Multiple choice question.

**TABLE 12:** Rating assigned by the PhVCs to the information required.

	Business Plan	Estimation of needed capital	Explanation of what the funds will be used to accomplish	Financial plan	Turnover	Audited accounts	Other
Mean	6.03	5.39	5.71	5.76	5.19	5.06	3.74
Median	7	6	6	6	5	6	4
SD	1.41	1.46	1.39	1.44	1.71	2.04	2.65

Scale: 1-7, where 1 = Not important at all, 3 = Neither important nor unimportant, 7 = Very important.

**TABLE 13:** Percentage of PhVCs rating the piece of information required as “Very important”.

	%
Business plan	55%
Financial plan	37.5%
Audited accounts	30%
Explanation of what the funds will be used to accomplish	30%
Turnover	25%
Estimation of needed capital	22.5%
Other	15%

**TABLE 14:** Kendall’s W statistics for information required.

Kendall's W	0.106
Chi-square	13.344
df	6
Asymp. Sig.	0.038

#### **b. Deal screening**

In terms of selection process, the same dimensions taken into account by traditional VCs were proposed in the questionnaire sent to PhVCs. However, different variables were also proposed to PhVCs. The difference between VCs and PhVCs selection variables reflects both the value proposition underlying the PhVC approach and the results obtained from the pilot interviews held with the leading PhVCs. The results are presented in Table 15. Table 16 lists those selection variables rated as “Very important” by respondent PhVCs.

Like VCs, PhVCs also rate the social entrepreneur and the management team as a very important variable to be considered in the selection process. Besides obtaining an overall rating close to 7, i.e., the maximum in our rating scale, the consensus of PhVC practices on this variable is confirmed both by the number of PhVCs who declared the variable to be “Very important” (87.5% of the respondents) as well as by the very low standard deviation associated to it (0.56). Quite surprisingly, the variable “Credible and sustainable revenue model and/or credible, sustainable funding plan” was rated as important, indicating that PhVCs tend to consider those SE that already have sustainable revenues or funding. This seems surprising, especially considering the claim that PhVCs help SE in becoming sustainable.

Unlike traditional VCs, who consider variables such as “Technology” and “Deal terms” as being relevant, PhVCs rate them as only marginally important. The result is confirmed by data in Table 16: only 7.5% of PhVCs rated “Deal terms” as very important, while none declared “Technology” to be important. As a matter of fact, PhVCs pay more attention to the dimension “Potential” than “Assessment of the deal”.

**TABLE 15:** Rating attributed to the variables considered by PhVCs in the selection phase.

<i>Dimensions</i>	<i>Variables</i>	<i>Mean</i>	<i>Median</i>	<i>SD</i>
<i>I. Entrepreneur and management</i>		6.82	7	0.56
<i>II. Activity of the social enterprise</i>	A. Business strategy	6.18	6	0.82
	B. Financial strategy	5.79	6	1.08
	C. Credible and sustainable revenue model and/or credible, sustainable funding plan	5.41	6	1.57
	D. The social enterprise is achieving clear outcomes with a significant number of people	5.28	5	1.68
	E. Technology	3.18	4	1.76
<i>III. External environment</i>	F. Social market served	5.85	6	1.31
	G. Market size	4.77	5	1.58
<i>IV. Assessment of the deal</i>	H. Fit in the PhVCs portfolio	5.21	6	2.04
	I. Deal terms	3.70	4	1.94
<i>V. Potential</i>	L. Potential significant social impact	6.33	7	0.90
	M. Potential to achieve scale	5.72	6	1.49
<i>VI. Other</i>		3.17	4	2.24

Sample size: 40; scale: 1-7, where 1 = Not important at all, 3 = Neither important nor unimportant, 7 = Very important.

**TABLE 16:** Percentage of PhVCs rating selection variables as “Very important”.

Dimensions	Variables	% of PhVCs
<i>I. Entrepreneur and management</i>		87.5%
<i>II. Activity of the social enterprise</i>	A. Business strategy	40%
	B. Financial strategy	27.5%
	C. Credible and sustainable revenue model and/or credible, sustainable funding plan	27.5%
	D. The social enterprise is achieving clear outcomes with significant numbers of people	35%
<i>III. External environment</i>	F. Social market served	42.5%
	G. Market size	10%
<i>IV. Assessment of the deal</i>	H. Fit in the PhVCs portfolio	35%
	I. Deal terms	7.5%
<i>V. Potential</i>	L. Potential significant social impact	55%
	M. Potential to achieve scale	40%
<i>VI. Other</i>		7.5%

In order to establish whether a relationship exists between the level of importance attributed by PhVCs to each selection variable and the legal structure of the fund as well as its “Assets under management” (AUM) corrected for size and the number of SE supported by stage of development, the Spearman’s correlation coefficient is calculated. Results are presented in Table 17. While we fail to reject the null hypothesis of no relationship between the level of importance for each of the selected variables and legal structure of the PhVC fund as well as corrected AUM, rejection and positive relationship is found for “Business Strategy” and “Credible and sustainable revenue model and/or credible, sustainable funding plan”. Surprisingly, a negative and significant correlation is found between the selection variables “Technology”, “Fit in the PhVC portfolio” and the number of expansion-stage SE supported by PhVCs.

Hypothesis 2c is tested, again using the Mann-Whitney U test: results are reported in Table 18. We find no statistical evidence that European and US PhVC funds rate all the selection variables proposed differently, except “Entrepreneur and Management team” and “Business strategy”. By analyzing the results obtained concerning these two variables in detail, European PhVCs tend to rate them higher than US variables (cf. Table 19). While all European PhVCs rate “Entrepreneur and Management team” as very important (mean and median score of 7), the average score attributed to this by US PhVCs is 6.61. The same is found for “Business strategy”: both rating and dispersion attributed by European PhVCs are higher than those assigned by US PhVCs.



**TABLE 17:** Spearman's correlation coefficient (rho) of selection variables with legal structure of the fund, AUM (corrected for size), and stage of supported SE .

		<i>I. Entrepreneur and Management</i>	<i>II. Activity of the social enterprise</i>					<i>III. External environment</i>		<i>IV. Assessment of the deal</i>	<i>V. Potential</i>	<i>VI. Other</i>		
			<b>A</b>	<b>B</b>	<b>C</b>	<b>D</b>	<b>E</b>	<b>F</b>	<b>G</b>	<b>H</b>	<b>I</b>	<b>L</b>	<b>M</b>	
<i>Legal structure</i>	Rho	-0.262	-0.036	-0.118	0.232	-0.182	-0.007	0.028	-0.087	-0.067	-0.034	-0.151	-0.063	0.155
	Sig. (2-tailed)	0.108	0.828	0.476	0.155	0.268	0.965	0.865	0.599	0.684	0.842	0.358	0.703	0.471
<i>AUM</i>	Rho	0.200	0.384*	0.261	0.481**	-0.245	0.106	0.62	0.026	0.262	0.264	0.072	0.255	0.355
	Sig. (2-tailed)	0.264	0.027	0.143	0.05	0.169	0.556	0.730	0.251	0.145	0.145	0.690	0.151	0.136
<i>Early stage</i>	Rho	-0.037	-0.065	-0.156	0.011	-0.130	0.046	0.050	-0.076	0.071	-0.217	0.226	0.019	-0.049
	Sig. (2-tailed)	0.834	0.709	0.372	0.952	0.458	0.792	0.775	0.665	0.685	0.225	0.191	0.913	0.837
<i>Expansion</i>	Rho	-0.031	-0.128	-0.099	0.017	0.131	-0.342*	0.271	0.164	-0.338*	-0.011	-0.011	0.228	0.007
	Sig. (2-tailed)	0.861	0.463	0.572	0.925	0.455	0.045	0.116	0.347	0.047	0.951	0.949	0.188	0.975
<i>Maturity</i>	Rho	-0.260	-0.018	-0.073	-0.120	0.157	-0.260	0.094	0.018	0.044	-0.027	-0.128	-0.123	0.174
	Sig. (2-tailed)	0.131	0.919	0.678	0.493	0.369	0.132	0.593	0.918	0.801	0.880	0.464	0.480	0.463

\* Correlation is significant at the 0.05 level (2-tailed).

\*\* Correlation is significant at the 0.01 level (2-tailed).

**TABLE 18:** Test for equality of European and US rating assigned to selection variables.

	<i>I. Entrepreneur and management</i>	<i>II. Activity of the SE</i>					<i>III. External environment</i>		<i>IV. Assessment of the deal</i>		<i>V. Potential</i>		<i>VI. Other</i>
		<b>A</b>	<b>B</b>	<b>C</b>	<b>D</b>	<b>E</b>	<b>F</b>	<b>G</b>	<b>H</b>	<b>I</b>	<b>L</b>	<b>M</b>	
Mann-Whitney U	37.50	21.00	47.00	52.50	49.00	58.50	59.50	58.00	27.50	54.50	51.00	50.50	58.50
Wilcoxon W	73.50	57.00	83.00	88.500	85.00	178.50	179.50	178.00	63.50	174.50	171.00	170.50	178.50
Z	-2.482	-2.717	-0.865	-0.504	-0.738	-0.10	-0.033	-0.134	-2.154	-0.363	-0.623	-0.639	-0.104
Asymp. Sig. (2-tailed)	0.013	0.007	0.387	0.614	0.461	0.920	0.974	0.893	0.031	0.717	0.533	0.523	0.917

**TABLE 19:** European and US rating of “Entrepreneur and management” and “Business strategy”.

	<i>Entrepreneur and management</i>			<i>Business strategy</i>		
	Mean	Median	SD	Mean	Median	SD
Europe	7	7	0	6.43	6	0.598
US	6.61	7	0.778	5.89	6	0.963

**c. Deal screening – Control variables**

This section presents control variables taken into account by PhVCs in the selection phase of their investments. More specifically, control variables refer to the investment policy that characterizes the respondent PhVC funds.

In terms of location, as proved by Tyebjee and Bruno (1984) in the case of traditional VCs, evidence that PhVCs tend to prefer the provision of support to those SE that are located in the country is found. Results are presented in Table 20.

**TABLE 20:** Percentage of PhVCs by policy on the location of the supported SE.

	%
In the PhVCs country	70%
In the PhVCs continent	5%
Africa	15%
Asia	5%
All around the world	17.5%

Table 21 presents data on the composition of PhVCs’ portfolio by sector. Data reported in the table take into account the number of SE funded by PhVCs, excluding co-investments. The results indicate that 72.5% of PhVCs invest in SE operating in the education field, holding an average of just under 20 enterprises belonging to this sector. However, considering the relatively high standard deviation, the portfolio number of education SE varies from fund to fund. The main aim of the support provided by PhVCs consists of improving school leadership and student achievement across the system. The “Other” category – which includes sectors such as civic engagement, human rights, economic development, food and nutrition, legal advocacy, and non-violence – is supported by 60% of the respondents; while the health sector is supported by 55%, with an average of almost 13 SE. Sectors such as employment, energy and environment, the disabled, housing, and water are covered by more than 20% of PhVCs.

**TABLE 21:** Percentage of PhVCs by supported sectors.

	<i>% of PhVCs</i>	<i>Mean</i>	<i>Median</i>	<i>SD</i>
Education	72.5%	19.65	3	49.54
Other	60%	27.8	1	129.27
Health	55%	12.67	1	43.42
Employment	47.5%	5.97	0.00	6.7
Energy and environment	45%	2.72	0.00	6.71
Disabled people	32.5%	3.02	0.00	10.64
Housing	30%	1.57	0.00	4.02
Water	20%	1.5	0.00	5.57

Table 22 analyzes the portfolio of PhVCs in terms of legal structure of the supported SE. PhVCs tend to provide their financial and non-financial support mainly to non-profit SE (37.5% of the overall respondents focus on the provision of capital as well as strategic advice only to non-profits) or to a combination of SE that are either non-profit or for-profit. Surprisingly, especially considering the reasons of the appearance and subsequent development of the PhVCs approach as a form of support available to SE,

PhVCs also support single projects or private individuals. Summing up those funds investing only in projects, with those supporting a combination of projects and SE (either non-profit and for-profit), 10% of the PhVC respondents back this category.

**TABLE 22:** Number of PhVCs by legal form of the supported SE.

	<i>% of PhVC</i>
Only non-profits	37.5%
Only for-profits	10%
Only projects/individuals	5%
Non-profits and For-profits	32.5%
Non-profits and Projects/individuals	2.5%
For-profits and Projects/individuals	2.5%
Non-profits, For-profits, Projects/individuals	10%

## CONCLUSIONS, LIMITATIONS, AND FUTHER RESEARCH

PhVC and VC appear to share many similar concerns and adopt comparable practices in the origination and assessment of investments. In particular, from the deal origination point of view, evidence of the use of the same passive criteria used by traditional VCs is found in the PhVC approach: both PhVCs and VCs tend mainly to use referrals through their network. The same result is found for proactive criteria. However, evidence of PhVCs using a source, i.e., direct creation of an SE, not identified in the VC literature, can be found. Alternatively, SE creation can be done through incubating existing SE to test either their business models or their suitability with PhVCs' portfolios; but this can also be achieved by directly setting up an ad-hoc SE in the event of a suitable SE not being found in the marketplace.

Similar to VCs, once PhVCs find out about a deal they tend to require a business plan with an estimate of the capital needed by the SE and an explanation of what the funds will be used for. Additional information, e.g. turnover and audited accounts, is also required.

The PhVC deal screening and selection process appears to follow the same path as the VCs. On the one hand, PhVCs and VCs explicitly take into account the same selection dimensions, i.e., entrepreneur, activity of the organization, external environment, assessment of the deal, and potential. Of course, considering the distinct value proposition of the two businesses, the measurement variable of each dimension is adjusted accordingly. Taking this into account, we find evidence that, as in the case of VCs, PhVCs rate the social entrepreneur and/or the management team as the most important dimension. Moreover, a positive correlation is found between this dimension and the assets under management corrected for size.

Also, SE business and financial strategies play a key role in the final decision. PhVCs also tend to consider SE with a credible and sustainable revenue model and/or a credible, sustainable funding plan. This is surprising, especially considering that the PhVC approach began to emerge in the late nineties as a way to help SE to become self-sustainable. Also surprising is the fact that PhVCs require SE to have achieved clear outcomes with a significant number of people: the role of the PhVC support should be precisely this but on an ex-post basis.

As opposed to VC practices, screening variables such as technology and deal terms are not rated as very important by PhVCs. However, these variables correlate with the number of expansion stages in the PhVCs' portfolio. On the contrary, they tend to focus their attention on the potential dimension both in terms of social impact and scalability. Other additional variables are taken into account only marginally.

Lastly, no statistical evidence of differences, neither in terms of deal origination nor deal screening, is found between European countries and the US.

The main limitation of the methodology used in the paper concerns the subjectivity of the responses involved in the questionnaire. In particular, the statistical relationships between subjectively assessed characteristics of deals and the PhVCs' decision regarding them may reflect a post-hoc rationalization of the decision. However, the issue is common in every survey based research.

The paper generates many research questions. Concerning deal origination, further research might first investigate whether PhVCs are more passive or proactive. Furthermore, it may also address the issue of the network approach and how PhVCs use it both passively and proactively as well as the identification of the determinant variables considered while PhVCs use the third source of deal origination, i.e., the direct creation of a social enterprise.

In terms of the deal selection process, further research might be aimed at investigating the characteristics of the social entrepreneur and of the management team that are considered essential by PhVCs.

## REFERENCES

- Amit, R., Brander, J., Zott, C. (1998). Why Do Venture Capital Firms Exist? Theory and Canadian Evidence. *Journal of Business Venturing*. 13 (6), p. 441.
- Bygrave, W. D., Timmons, J. A. (1992). *Venture Capital at the Crossroads*. Harvard Business School Press. Boston, MA. p. 356.
- John, R., 2006, "Venture Philanthropy: the Evolution of High Engagement Philanthropy in Europe", Skoll Centre for Social Entrepreneurship, Saïd Business School Publications.
- Kaplan, S., Stromberg, P. (2001). Venture Capitalists as Principals: Contracting, Screening, and Monitoring. *American Economic Review*. 91 (2), pp. 426-430.
- Letts, C. W., Ryan, W., Grossman, A. (1997). Virtuous Capital: What Foundations Can Learn From Venture Capitalists. *Harvard Business Review*. 75 (2), pp. 36-44.
- MacMillan, I. C., Siegel, R., Narasimha, S.B. (1985). Criteria Used by Venture Capitalists to Evaluate New Venture Proposals. *Journal of Business Venturing*. 1 (1), pp. 119-128.
- Meyskens, M. A., Post, C. (2008). Social Venture Strategy from a Global Perspective: An Exploratory Study Assessing Ashoka Fellows. Available at SSRN: <http://ssrn.com/abstract=1148492>
- Porter, M. E., Kramer, M. R. (1999). Philanthropy's New Agenda: Creating Value. *Harvard Business Review*. 77 (6), pp. 121-130.

- Quindlen, R. (2000). *Confessions of a Venture Capitalist: Inside the High-Stakes World of Start-up Financing*. New York, NY: Warner Books, p. 218.
- Rea, R. H. (1989). Factors Affecting Success and Failure of Seed Capital/start-up Negotiations. *Journal of Business Venturing*. 4 (2), pp. 149-158.
- Scarlata, M. R., Alemany, L. (2008). Financing Social Entrepreneurs: Philanthropic Venture Capital vs. Foundations. Paper presented at the BCERC conference, Chapel Hill, NC, June 4-7.
- Smart, G. H. (1999). Management Assessment Methods in Venture Capital: An empirical analysis of human capital valuation. *Venture Capital*. 1 (1), Jan-March, pp. 59-82.
- Sweeting, R. C. (1991). UK Venture Capital Funds and the Funding of New Technology-Based Businesses: Process and Relationships. *Journal of Management Studies*. 28 (6), pp. 601-622.
- Tyebjee, T. T., Bruno, A. V. (1984). A Model of Venture Capitalist Investment Activity. *Management Science*. 30 (9), pp. 1051-1056.
- Van Slyke, D. M., Newman, H. K. (2006). Venture Philanthropy and Social Entrepreneurship in Community Redevelopment. *Non-profit Management & Leadership*. 16 (3), pp. 345-368.

**APPENDIX 1:** Number of PhVC funds (population and sample) by legal structure.

	<i>Population</i>	<i>% over population</i>	<i>Sample</i>	<i>% over sample</i>
Foundation	21	28.4%	16	40%
Public charity	30	40.5%	8	20%
Donor-advised fund	3	4.1%	4	10%
Trust	1	1.4%	1	2.5%
Other	1	1.4%	4	10%
<i>Total non-profit</i>	<i>56</i>	<i>75.5%</i>	<i>33</i>	<i>82.5%</i>
For-profit	8	10.8%	7	17.5%
Missing	10	13.5%	-	-

**APPENDIX 2:** Number of PhVC funds (population and sample) by nationality.

	<i>Population</i>	<i>% over population</i>	<i>Sample</i>	<i>% over sample</i>
Continental Europe	20	27.03%	13	32.5%
Eastern Europe	3	4.05%	1	2.5%
UK	15	20.3%	8	20%
<i>Total Europe</i>	<i>38</i>	<i>51.4%</i>	<i>22</i>	<i>55%</i>
USA	36	48.6%	18	45%

**APPENDIX 3:** Number of PhVC funds (population and sample) by year of foundation.

	<i>Population</i>	<i>% over population</i>	<i>Sample</i>	<i>% over sample</i>
1980 - 1990	2	2.7%	2	5%
1991 - 1999	26	35.1%	10	25%
<i>Total 1980 - 1999</i>	<i>28</i>	<i>37.8%</i>	<i>12</i>	<i>30%</i>
2000 - 2004	31	41.9%	17	42.5%
2005 - 2008	11	14.9%	11	27.5%
<i>Total 2000 - 2008</i>	<i>42</i>	<i>56.8%</i>	<i>28</i>	<i>70%</i>
Missing	4	5.4%	-	-

**APPENDIX 4:** Assets under management (AUM) of sample PhVC funds.

	<i>Population</i>	<i>% over population</i>	<i>Sample</i>	<i>% over sample</i>
<i>AUM</i>				
0 – 1 M \$	4	5.4%	5	12.5%
1.01 M – 5 M \$	6	8.1%	6	15%
5.01 M – 10 M \$	11	14.9%	9	22.5%
10.1 M – 20 M \$	8	10.8%	7	17.5%
20.1 M – 50 M \$	8	10.8%	3	7.5%
50.1 M – 100 M \$	2	2.7%	1	2.5%
100 M – 1 B \$	4	5.4%	2	5%
More than 1 B \$	1	1.4%	1	2.5%
Missing	30	40.5%	4	15%