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A longitudinal comparison of capital structure between young for-profit social and commercial enterprises

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ABSTRACT

We develop a new perspective on capital structure differences between for-profit social and commercial enterprises by combining imprinting and social entrepreneurship theory. Using a longitudinal matched sample, we find that for-profit social enterprises have 40% to 13% lower leverage and up to four times greater leverage stability over time than commercial enterprises. Our results suggest that these differences in capital structure derive from the process of prosocial organizing, which goes beyond the primary focus on financial preferences. Thus, for-profit social enterprises—and similar hybrid organizations, such as B corporations—may require theories adjusted to their context.

1. Executive summary

There is a growing interest in the financing of social enterprises (Bruton et al., 2015; Fleming and Sorenson, 2016). Nonetheless, the existing entrepreneurial finance literature, with its often explicit focus on profit maximization, has a significant gap in both theorizing and empirical evidence regarding the extent to which capital structures of for-profit social enterprises differ from commercial enterprises. We draw on imprinting theory and the social entrepreneurship literature to develop a new perspective on how capital structure differences emerge and evolve between for-profit social and commercial enterprises.

Taking an imprinting theory perspective (e.g., Boeker, 1989; Stinchcombe, 1965), entrepreneurs are expected to shape capital structures at founding and initial capital structures will have a lasting influence on future capital structures. Entrepreneurs in for-profit social enterprises want to create value for society and aim to find sustainable solutions to social and environmental problems (Mair et al., 2012; Santos, 2012). Because social goals often require longer term investments (Bacq and Lumpkin, 2014), for-profit social entrepreneurs also tend to have a longer term orientation than commercial entrepreneurs. Consequently, for-profit social entrepreneurs may prefer to avoid situations where they have to subordinate their (longer term) social goals to the (shorter term) financial necessity of having to make strictly-timed debt payments. Therefore, our first hypothesis states that over time capital structures of for-profit social enterprises will include less debt financing than commercial enterprises.

Social entrepreneurs, with compassion and motivation to create social value (Miller et al., 2012), are unlikely to compromise their social goals, when more debt becomes optimal from a purely financial perspective, thereby making their capital structures more persistent. Furthermore, attention is a scarce resource, particularly for for-profit social entrepreneurs, who are managing more complex, hybrid organizations (Stevens et al., 2015b). Consequently, for-profit social entrepreneurs may also spend less attention to

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analyzing and adjusting their capital structures than commercial entrepreneurs. Therefore, our second hypothesis states that the influence of initial leverage ratios on future leverage will remain stronger over time among for-profit social enterprises than commercial enterprises.

To test these hypotheses, we use a quasi-experimental approach. Specifically, we construct a longitudinal dataset from 2005 to 2015 comprising 120 young for-profit social and 120 commercial enterprises, matched by industry, firm age, and firm size. From the Flemish government (a regional government in Belgium), we obtained the population of Flemish firms that carry the “Social Purpose Company” (SPC) legal label. SPCs are similar to Certified B Corporations (B Corps) with regard to the requirements of carrying a for-profit legal form, pursuing both for-profit and social goals, and having a formal commitment to assessing and reporting social impact. The for-profit social enterprises and matched commercial enterprises in our sample are subject to the same accounting standards and report detailed yearly financial accounts data to the Belgian National Bank in a predefined format. Using this unique dataset, we find support for our hypotheses. Specifically, capital structures tend to have lower debt levels and are significantly more stable over time within for-profit social enterprises compared to commercial enterprises.

Our study contributes to the entrepreneurial finance literature by providing a first-time longitudinal glimpse in how capital structures of for-profit-social and commercial enterprises differ over time. Capital structure and the use of debt plays a crucial role in firms and can significantly influence firm survival and growth (Åstebro and Bernhardt, 2003; Robb and Robinson, 2014). Our findings suggest that important differences in capital structure derive from imprints of prosocial organizing of capital structure—an element that has been largely overlooked in traditional capital structure theories. Thus, standard capital structure theories need important adjustment for the context of for-profit social enterprises. In this way, our study also contributes to the social entrepreneurship literature by emphasizing substantive differences between for-profit social and commercial enterprises (Santos, 2012) and how these differences generate distinct expectations of entrepreneurial behaviors including capital structure decisions. Finally, this study helps inform stakeholders and policy makers about the challenges and consequences of capital structure decisions while pursuing both economic and social goals, as well as the relevance of financing sources for new for-profit social enterprises that fit with their hybrid goals.

2. Introduction

Scholars have shown growing interest in the unique challenges of financing social enterprises (Bruton et al., 2015; Fleming and Sorenson, 2016). The theme of financing social enterprises is examined from various angles including crowdfunding (Allison et al., 2015; Dushnitsky et al., 2016), investor decision making (Moss et al., 2015; Thébaud, 2015), and new organizational and legal forms (Haymore, 2011; Reiser, 2010). Moreover, it is often argued that social entrepreneurs tend to be cautious about adding outside financing sources to their financial structure (Sunley and Pinch, 2012) and that they experience particular difficulties in identifying and accessing funding sources that are interested in creating social value at the expense of financial returns (Calic and Mosakowski, 2016; Certo and Miller, 2008; Doherty et al., 2014).

The existing entrepreneurial finance literature, however, has a significant gap in both theorizing and empirical evidence regarding the extent to which capital structures of for-profit social enterprises emerge differently and how these differences evolve in their entrepreneurial journeys over time compared to commercial enterprises (McMullen and Dimov, 2013). Theoretically, standard capital structure perspectives assume profit maximization as the entrepreneur's sole objective (Sapienza et al., 2003) and they largely ignore the role of differences in company long-term orientation (Bacq and Lumpkin, 2014), which are problematic when comparing social and commercial entrepreneurs. Empirically, studies of capital structure have almost exclusively examined young or small commercial enterprises (Cassar, 2004; Cosh et al., 2009).

In this study, we examine the following research question: *How does capital structure differ between young for-profit social and commercial enterprises over time?* We develop a new perspective based on imprinting theory and the social entrepreneurship literature. Specifically, we hypothesize that there will be two types of differences in capital structures between for-profit-social and commercial enterprises. First, over time capital structures of for-profit social enterprises will include less debt than capital structures of commercial enterprises. Second, over time the relationship between initial capital structure and future capital structure will remain stronger for for-profit social enterprises relative to commercial enterprises.

We empirically test these hypotheses using a longitudinal matched sample of young for-profit social enterprises and commercial enterprises (i.e., pure for-profit businesses in various industries). The for-profit social enterprises in our sample state their social aim in their statutes, explicitly integrate social objectives, publish a special annual report assessing their performance, and carry the legal label “Social Purpose Company” (SPC) in Belgium (Stevens et al., 2015a; Szymańska et al., 2015). SPCs are considered a progenitor to B corps and Benefit Corporations as they were introduced into the Belgian Company Code in 1995 (Defourny and Nyssens, 2008). Our findings support our hypotheses.

Our findings are relevant to the emerging body of work on prosocial hybrid organizations including B Corps (Gehman and Grimes, 2017) because the for-profit social enterprises in our sample share several similarities with other for-profit hybrid categories (Rawhouser et al., 2015) and differences compared to commercial enterprises. Specifically, our study is one of the first to examine capital structure differences between legally acknowledged for-profit social enterprise forms and commercial enterprises. Our results show important differences in capital structure, which given our matched sample, most likely derive from imprints of prosocial organizing of capital structure that goes beyond financial preferences. Because prosocial organizing of capital structure is largely ignored in existing capital structure theories that take a profit maximizing paradigm, our findings highlight how for-profit social enterprises (and similar hybrid organizations) require theories adjusted to their specific context (e.g., Santos, 2012; Wry and York, 2017).

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