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Deal Structuring in Philanthropic Venture Capital Investments: Financing Instrument, Valuation and Covenants

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Abstract

Philanthropic venture capital (PhVC) is a financing option available for social enterprises that, like traditional venture capital, provides capital and value-added services to portfolio organizations. Differently from venture capital, PhVC has an ethical dimension as it aims at maximizing the social return on the investment. This article examines the deal structuring phase of PhVC investments in terms of instrument used (from equity to grant), valuation, and covenants included in the contractual agreement. By content analyzing a set of semi-structured interviews and thereafter surveying the entire population of PhVC funds that are active in Europe and in the United States, findings indicate that the non-distribution constraint holding for non-profit social enterprises is an effective tool to align the interests of both investor and investee. This makes the investor behaving as a steward rather than as a principal. Conversely, while backing non-profit social ventures, philanthropic venture capitalists structure their deal similarly as traditional venture capital, as the absence of the non-distribution constraint makes

such investments subject to moral hazard risk both in terms of perks and stealing and social impact focus.

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