Enhancing the Competitiveness and Sustainability of Social Enterprises in Hong Kong: A Three-Dimensional Analysis

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Background

"Social enterprise" is a hybrid organization mixing non-profit and for-profit elements, conducting business activities to generate profit to finance a social, educational, cultural, religious, or charitable cause. It is essential that an SE can generate profit and return, so to invest in social activities or support a social cause.[1]

The Hong Kong SAR Government and social service sector have been actively promoting the development of social enterprises with entrepreneurial thinking and innovative approaches, to enable the socially disadvantaged to be self-reliant through employment, and to meet the needs of various community groups. The social enterprise (SE) sector in Hong Kong has grown rapidly over the past 10 years. According to the Hong Kong Council of Social Service - Social Enterprise Business Centre, the number of SEs significantly increased from 222 in 2008[2] to 654 in 2017[3]. A total of 301 organizations carried out SE projects, with 147 of them possessing charitable status. SEs generate substantial social value and jobs for the socially disadvantaged in the community. SEs are also important to advance social entrepreneurship and mobilize social innovation.

However, many SEs with important social missions have failed after a few years or are struggling to survive. The findings of Fullness Social Enterprises Society Report (2015) provide a glimpse into SE sustainability. The Report shows that only 19% of SEs were able to achieve break-even or profit by the end of their second year in operation. The percentage of profitable SEs by the end of the fifth year increased to 53%. This improvement is encouraging, but also points out a harsh reality that many SEs suffer losses in their operations. The 2015 Report also shows that 23% of SEs ceased operations within 5 years and the non-survival rate increased to 55% within 10 years.

As part of the transformation from mainly relying upon government funding for achieving social missions to being sustainable SEs, SEs are now facing not only the challenge of achieving social missions but also economic sustainability. There is an increasing demand from SE practitioners, the government and other stakeholders for a better understanding of what causes the success and failure of SEs in Hong Kong. This study aims at addressing the challenge of enhancing the

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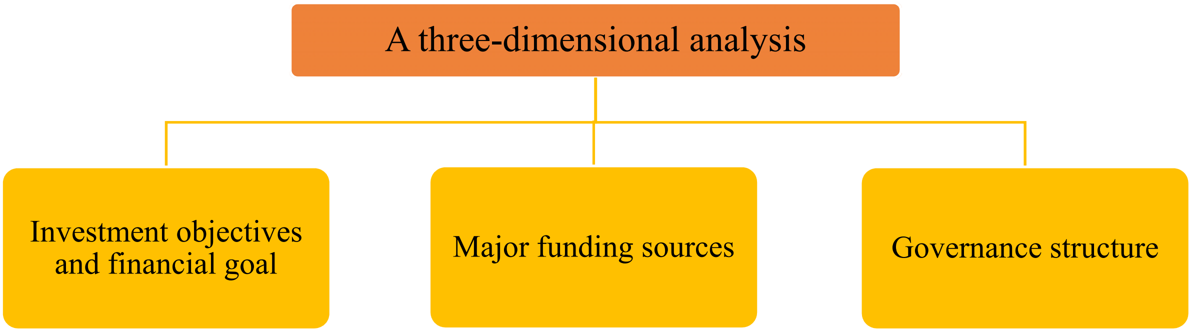
1 https://ebrary.net/8682/business_finance/social_enterprise_financial_sustainability
2 http://www.hkcss.org.hk/uploadfileMgnt/0_2014116151119.pdf
3 https://socialenterprise.org.hk/zh-hant/content/%E3%80%8A%E7%A4%BE%E4%BC%81%E6%8C%87%E5%8D%972018%E3%80%8B%E7%B6%93%E5%B7%B2%E6%8E%A8%E5%87%BA

competitiveness and sustainability of Hong Kong SEs using a three-dimensional analysis. Specifically, this study focuses on the impacts of three key dimensions of social entrepreneurship on the SE's profitability, business planning and management. The three dimensions of SEs are namely (1) investment objectives and financial goal; (2) major funding sources; and (3) governance structure.



Participating SEs

Through two rounds of invitation sent to randomly selected SEs, a total of 22 SEs agreed to participate in this Study. In-depth interviews based on the questionnaire were conducted with the owner/founder or key manager of each selected SE during the period from December 2017 to April 2018.The participating SEs in this Study mainly operated in *retail* businesses (45%), *catering* businesses (23%), and *workshops* (14%).

Regarding SEs' investment objectives, 55% of SEs aimed at dual investment objectives, i.e. a mixture of social impact and financial return whereas the remaining 45% of SEs revealed social impact to be their sole investment objective. In terms of financial goals, only less than one third of the sample SEs (32%) rated '*profitability*' (business revenues should exceed expenses) as their financial target. Nearly half of the SEs (45%) aimed at '*self-sufficiency*' (business revenue should cover expenses) as the financial goal, indicating that they are satisfied as long as their SE was not making a loss. Another 23% of SEs accepted losses and their financial goal was '*contribution*' (business revenue cover part of costs).

In terms of profitability, 27% of SEs never made any profit at all in any single year over the past 5 years (no profitability), 41% of SEs generated profit during 1 to 3 years out of the past 5 years (moderate profitability), about one third of SEs (32%) recorded profit in at least 4 years out of the past 5 years (high profitability).

In terms of main funding source, 41% of SEs relied on private funding, 32% on funding support from non-governmental organizations (NGOs) and 27% on government funding. Regarding governance structure, the majority (64%) of SEs were run by a non-owner manager. In the remaining 36% of SEs, the owner also served as the key manager. 45% of SEs had established an overseeing/advisory committee and 55% of SEs did not have such a committee.

Investment Objectives and Financial Performance Perspective

SEs with dual investment objectives of social mission and financial return are more sustainable and competitive than SEs with the only investment objective of social impact; SEs with dual investment objectives had an average of 2.75 profitable years in the last 5 years, outperforming SEs with a sole objective of social impact (2.1 profitable years).

High-profitability SEs (those that have at least 4 profitable years in the last 5 years) are more likely to aim at either '*self-sufficiency*' or '*profitability*' as their financial goal and to adopt more rigorous business and financial management than low-profitability SEs. Specifically, 86% of high-profitability SEs aimed at either '*self-sufficiency*' or '*profitability*' as their financial goal. In contrast, 50% of no-profitability SEs considered '*contribution*' (business revenues cover part of costs) as their financial goal. Over 70% of high-profitability SEs had a business plan and were more likely to use budgeting to measure business performance than no-profitability SEs. Also, high-profitability SEs produced cash flow forecasts more frequently compared to no-profitability SEs.

Funding Source Perspective

We partitioned the sample into three groups based on their major funding sources, namely NGO-funding, government-funding, and private-funding. We compared various attributes of their business and financial management. We find that 86% of NGO-funding SEs had dual investment objectives, reflecting that NGOs typically expect their SE subsidiaries or units to earn profit and be self-sustainable. Indeed, NGO-funding SEs were the most profitable with an average of 3.29 profitable years in the last 5 years. Only 33% of government-funding SEs had dual investment objectives. Although many government-funding SEs had a single objective of social impact, their profitability index (2.67 years) ranked second out of the three groups. It is alarming that private-funding SEs had the poorest record of profitability (1.67 years only) even though they had ranked '*profitability*' as their first preference in terms of financial goal. Government-funding SEs however had the lowest scores in financial planning and management.

Governance Structure Perspective

Like any for-profit enterprise or a family firm, how a SE is managed is likely to be different if the owner serves as the key manager. The governance structure differed among SEs funded by different sources. Specifically, 67% of private-funding SEs were run by owner managers, compared with 33% for government-funding SEs. As expected, all NGO-funding SEs were managed by professional managers. The establishment of an overseeing/advisory committee was not common in private-funding SEs (33%). Half and slightly more than half of government-funding and NGO-funding SEs respectively had an overseeing/advisory committee.

We analyze the differences in profitability and business management practices between owner-manager SEs and non-owner-manager SEs. The results show that non-owner-manager SEs performed better in profitability (2.71 years) than owner-manager SEs (2 years). Compared to owner-manager SEs, non-owner-managers SEs had more detailed budget including capital expenditure and operating expenditure of start-up costs and were more likely to profile competitors in the business plan. Non-owner-manager SEs were also more sophisticated in financial planning and management. These findings are consistent with the notion that SEs managed by a non-owner key manager are more competitive and sustainable than owner-manager SEs.

We also address the question "Does having an overseeing/advising committee matter in SEs in Hong Kong?" The results show that SEs with an overseeing committee prepared more detailed budgets and had a greater tendency to adopt updated business plans than SEs without an overseeing committee. SEs with an overseeing committee also developed their business start-up plans more comprehensively and thoughtfully such as setting up a supply chain for their product/service in business start-up plans.

Policy Implications and Recommendations

Collectively, the research findings in this Study show that Hong Kong SEs are in general not yet embracing the importance of financial sustainability, nor the notion of "social enterprise" as being a for-profit business, i.e. to primarily work for generating profit which is to be reinvested in not-for-profit activities.

To enhance the competitiveness and sustainability of the SE sector in Hong Kong, we have the following recommendations for various stakeholders including existing/new SEs, government, funding bodies and NGOs.

(1) For SEs

- SEs should embrace realistic and sustainable dual investment objectives and should manage and run their enterprises from a sustainability point of view.
- SEs should prepare quarterly, if not monthly, cashflow and profit and loss forecasts, evaluate the operating performance with the forecasts and revise business plan and forecasts accordingly. When applying for government funding, SEs should profile customers and competitors in the business plans, include capital expenditure and associated depreciation expenses in the financial statements.
- SEs should establish an overseeing/advising committee with at least 3 members, at least one from sales and marketing, one from accounting/finance and one from the expertise in the related industry.

(2) For Government and funding bodies

- The government or NGOs should expand their effort by actively recruiting retired professionals and to consolidate a pool of experts as potential mentors/ consultants to all SEs including private-funded SEs.
- The government should consider a new funding scheme to provide one-off funding support for start-up capital expenditure to competitive private SEs.

- The assessment panel for government funding schemes should be expanded to include at least 3 members who collectively have expertise in sales and marketing, accounting and finance as well as related businesses.

(3) For HKCSS

- The gap analysis of skill sets of key managers highlights the need of business training to SE managers. The HKCSS Institute should be responsible for providing more training workshops to SEs especially in the areas of sales and marketing, product/service knowledge, business management, accounting and financial management.
- The HKCSS Institute should invite existing managers and practitioners of successful SEs as trainers to share their experience in the training workshops.