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Conference Paper

The new wave of social entrepreneurship - 2009

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The Global Society

The New Wave of Social Entrepreneurship – 2009

The Challenges

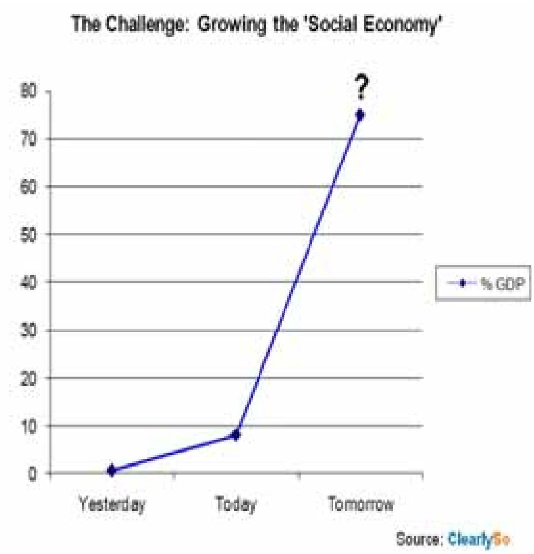
In the aftermath of the collapse of the western financial system, many observers agree that neither unfettered financial markets nor invasive regulation are able to ensure that financial and business leaders will necessarily act in the public interest.

While governments are pondering how to provide a legal and political framework that better aligns the needs of businesspeople and society at large, a new class of economic agents has emerged that aim to give explicit consideration to both social and economic gains.

These agents are the social entrepreneurs. Armed with the tools of commerce and markets, they use their creativity, skill, cunning and hard work to found social enterprises which deploy the methodology of capitalism for outcomes of a social nature.

Social businesses have been developed and are prospering which effectively create, in different measure, financial and social returns. They harness capital from a new breed of socially minded investors, whose returns horizons have broadened from a focus purely on financial return and risk, to one which also addresses the social element of returns. Such investors have moved on from the Socially Responsible Investment (SRI) concept of the 1980s to become more proactive and positive in their investment. Two asset classes from the social investment arena have already entered the traditional investment mainstream (Cleantech and Microfinance) which has greatly increased capital flows to these sectors.

Which global problems can and should be addressed most effectively by social entrepreneurship and social investment? In which asset classes will it prove particularly effective in the future, and how can we increase their importance in these classes? How can governments provide an institutional and legal setting to enhance the power of social entrepreneurship to address problems such as poverty, inadequate infrastructure, health problems, education and training, welfare provision? How can social entrepreneurs interact with international organizations and NGOs to promote the global public interest? To what extent will government intervention or interaction with NGOs undermine the credibility and long term effectiveness of social entrepreneurship?



Proposed Solutions

Nejira Nalić

Executive Director, Micro Credit Foundation MI-BOSPO Tuzla

Why would it be a good option to ensure existence of a microcredit organization as a socially responsible business?

Microcredit has found a new market – as a financial service. It has recognized effort of low income people to work towards their own solutions in finding economic potentials in their communities. Credit helps maintain and sometimes even grow these potentials.

Microcredit organizations in Bosnia and Herzegovina ensured interest in serving low income people – competition was/is high and people were ensured access to this financial service. Interest rates were going down. Financial offer became a visible, respected and criticized, too.

There are 12 organizations in the country, serving some 370,000 clients with EUR500 million. Most of them are financially sustainable and have high return on equity. Interest rate dropped, since 1996, by 10% and with some bigger organizations, even by 15%. It is important to understand that outreach made it possible but also competition.

It was important to grow, offer credit to as many economically active low income people as possible and ensure efficient delivery channels. This is what is different from the banks, so even in B&H market, even once one can see that banks are accessible, clients were turned to microcredit organizations due to this particular service and offering.

Demand was high and there was a high optimism in society about providing loans – believing that organizations are able to make a decision about loan based on their strict methodologies and believing that clients will not take more loans than they can repay. Both sides built trust and understanding and there was a lack of critical view in looking in the future of liability management.

Precondition for having a healthy offering and clients protection is financial education. In some ways this has been a missing step – once sector started its inevitable growth. It is to be discussed if financial education could have prevented some cases of over indebtedness in B&H market, but it is important that these services are offered hand in hand with credit.

So, even if microcredit organizations were established for clients – mission driven, financed by socially responsible lenders, it is important to ensure that high principles of social responsibility are questioned and that client's protection is not seen as given.

Alex Nicholls

University Lecturer in Social Entrepreneurship, Oxford University

Institutional reform is the key

Currently we find ourselves in uncharted territory with respect to the future of capital markets. Whilst the prospect of an imminent meltdown in global markets appears to have receded, the likely long-term impacts of the global recession are still difficult to discern. Keynesians may have regained significant ground but the neo-liberal rearguard reaction has also been strong and concerted – so much so that the Economist (21.8.09) is now recasting the recession as an opportunity to reduce rather than increase the size of government going forward. However, what seems plain is that financial business as usual will not be an option despite the concerted efforts of the big institutions. So what are the alternatives? There is a growing consensus that reembedding capital markets in their proper social and environmental context – something

traceable right back to Smith's other great work "The Theory of Moral Sentiments" – will represent an important element in building sustainable capital markets going forward. Such a process will recast risk and return calculations, draw new boundaries between value creation and value appropriation, and will capture – and exploit – externalities in new and creative ways. All of these innovations offer potentially positive outcomes for investors and investees alike, as well as society at large. So how will these changes come about? And how will we know that transformation is underway?

History tells us that the development of financial markets has typically been the product of the – at times fractious – interplay of four main interest groups: investors (as suppliers of capital), investees (as providers of deals), financial institutions (as intermediaries), and government (as regulator representing the public good). As we look to move towards the new markets and institutional structures of the future all four players will need to change. But who will drive the change?

Two candidates stand out. First, will be the providers of capital. Here the emergence of more "social" investors seeking Blended Value outcomes will be critical – happily this is already evident. Second, will be government. Whilst it may be unfashionable to recognise how critical government is to the proper functioning of society, the evidence is unquestionable. It is also plain that government – as the lawmaker and financial regulator – can have an enormous influence on the shape and functioning of capital markets. The influence of government policy on capital markets 2.0 must, therefore, be seen as the other important piece alongside investor preference. There are signs too that this is already happening – though the response of some countries (notably the UK) has been frustratingly timid thus far. So this leaves the question of how will we know if change is underway?

Mulgan (in prospect this year) proposed a number of key indicators of the evolution of a new capitalism. These included: greater volumes of capital committed to social investment; radical changes in work patterns; the continued rise of ethical consumption (Fair Trade, organic, green products etc); and greater attention to externalities and the value of public goods. I would add to these that we need to pay close attention to the growth of social entrepreneurship already evident across the world – from Benetech in California to Honey Care in Africa and Aravind Eye Hospitals in India . These ventures are the pathfinders for new business models that go far beyond the superficial attractiveness of many "Bottom of the Pyramid" examples. What unites them is a performance-driven market orientation that combines an aggressive focus on improvement and growth with a keen sense of the need for accountability and legitimacy. Learning from social entrepreneurship tells us that the next wave of capital markets need to be not only to be performance driven, but also more accountable and transparent to a much broader range of stakeholders if they are to be successful in the new global economy.

Rodney Schwartz

CEO, ClearlySo

We assert that social business, enterprise, commerce and investment should and could form a larger part of economic activity in the future. We also believe it will take place. What is unlikely, in the current fiscal predicament, is that such a process will be greatly aided by governmental funding. In our opinion this could also undermine both the credibility and the long term effectiveness of this trend. In addition to possible interference by political interests with an agenda, any meaningful state subsidy will delay rather than accelerate the point where the sector becomes self-sustaining. In the accompanying documents we all have listed a set of solutions, each of which are meant to stand on their own. There has been NO attempt to integrate these at this stage into a policy recommendation and the author of each is listed at the end of each solution.

The fiscal code needs to be more "tilted"

Tax laws in most countries fail to fully adjust for the negative externalities caused by economic agents. Polluters are increasingly paying for their damage, but few observers believe they are charged their full marginal cost to society for the harm they cause. That is simply borne by existing and future generations of taxpayers. In the banking system, we have learned that the state bore the explicit guarantee of the system, at a cost of trillions of Euros. This is a negative externality which, in few of the proposals we have seen, will earn back such sums. The same is true of polluting industries and others – but tax codes are becoming more tilted to such externalities – a carbon tax will accelerate this, for example. We would urge that this process is greatly accelerated. Moreover, why not also reward those firms which generate positive externalities? Why not provide a credit for a portion of the savings of the state for expenditure which otherwise would have been incurred? We would urge the speedy adoption of a move in this direction.

Greater understanding of this new area, especially in financial services

Regulators are rightly feeling a bit “gun-shy” about innovation in financial markets – especially around investment vehicles. The explosion of many of the newest asset classes has left both regulators and investors with declining risk appetites. The fact that social entrepreneurs and many of the socially minded investors behind them are not solely interested in financial returns at all costs makes them unusual—and in our view, well-suited to the New Economy. However, by definition that means that existing financial instruments are also not suitable. The social mission of the enterprise is very ruthlessly protected and not subject to the “market for control.” Thus equity investment, in particular, needs to be re-defined or reformed in order to suit this sector. This and other financial innovation can have a strong social element and needs to be encouraged rather than stifled by investment regulators.

More emphasis on intermediary structures

Mainstream entrepreneurs have an entire infrastructure which is designed to assist them to be successful. It includes bankers, lawyers, accountants, analysts, the venture capital community, advisors, consultants and others who, in varying quality, help entrepreneurs to succeed. Social entrepreneurs have no such infrastructure. We recommend it be developed. Private companies and foundations as well as governments and NGOs all over the world are beginning to put this infrastructure into place. Mainstream players in these markets would be well-advised to consider entry thereby leveraging their expertise and skill set, but need to be conscious of the multi-faceted objective sets of social entrepreneurs.

Far greater focus on the “supply” side

New funds are created easily with the stroke of a pen and the transfer from a bank account. On the other hand, great enterprises take a decade or more to bring into existence. We urge that all parties address this problem through more strenuous effort to build businesses and a simultaneous de-emphasis on new funds. In the absence of sufficiently attractive social business propositions increased funding will only dampen returns, obviously. The services which will increase supply include “investor readiness” services, which assist social entrepreneurs by turning their projects into “backable” projects. A greater emphasis on mentoring of entrepreneurs and building top-flight Boards will assist in this regard.

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Bill Young

President, Social Capital Partners

“Reverse engineering” existing businesses to have a social dimension

The easiest way to explain this idea is by using the example of how our strategy has evolved at Social Capital Partners. We began by funding and working with social enterprises which we defined as businesses where at least half the employees were disadvantaged. Over our first five years we financed and worked with a handful of these companies to help them grow, achieve profitability and attain a sustainable livelihood for the people that were employed.

On the one hand we were very pleased with the results. The social enterprises in our portfolio from this phase are terrific companies that have proven beyond the shadow of a doubt that you can make both the financial and the social dimensions of a social enterprise work. We couldn’t be prouder of being associated with them.

On the other hand it took us more than 5 years to help develop these businesses to provide a few hundred jobs. We knew that a few hundred jobs wasn’t much in the global scheme of things and as Rod mentioned we knew that it can take the better part of 10 years or more to scale companies when you are starting from scratch. That’s when we asked ourselves: Could we take already scaled businesses and somehow turn them into social enterprises without calling them that?

So we developed a loan product that effectively offers attractive subordinate debt financing to growing private sector companies in return for them committing to using our social hiring program. We actually tie our interest rates to the number of social hires they make so that their financing costs come down as they become more committed to our social purpose. In effect we turn them into social enterprises without having to build from scratch.

That is a micro example of this idea but I believe there are potentially numerous ways to apply it. While the example above is based on building a “product” that accomplishes the goal there is probably much more leverage by mobilizing demand or consumer buying power to bring a social dimension to an existing company. One only needs to look at the Fair Trade movement and how it has created change at such large companies like Starbucks to see the power consumers have to create social good.

The real point is that I think too often those of us who are part of the social entrepreneurship sector look for “purpose built” solutions as opposed to “reverse engineering” solutions. My belief is that sometimes it’s easier to create social entrepreneurs by taking conventional commercial entrepreneurs and give them a reason to become social ones consciously or unconsciously and we should apply more of our creative thinking to figuring out how to do so.

New capital for social investment

There is an obvious source of significant new capital that governments could create for social investment without having to put the money up themselves or issue any new tax credits (which given the world’s current economic challenges new funding and additional tax credits are hard to come by). That source is in private foundations.

The current way most private foundations are organized and regulated in developed countries is they are required to donate or grant only somewhere between 3 and 6% of their assets in any given year to charities. The other 94 to 97% of their assets are generally handed over to

investment management companies who invest that money in very traditional investment instruments that have no social purpose whatsoever and are not linked in any way to the mission of the foundation.

This makes no sense to me from a couple of different perspectives. First of all if the purpose of foundations is to do good how can any foundation live up to their potential if they only harness 5% of their assets to further their mission? Try and think of any other organization in the world that only uses 5% of its assets in pursuit of their goals. I can’t think of any.

Second, I think this current way of operating is a terrible deal for taxpayers and governments. In many cases governments give up to a 50 cent on the dollar tax credit for an individual to start a foundation and only require that 5 cents on the dollar be put back on an annual basis to do societal good. That seems like a pretty poor return on a taxpayer dollar to me.

A simple solution would be for governments to require that foundations invest at least 10 percent of their assets in social investments. Obviously some thought has to be put into what constitutes a social investment (it doesn’t mean an ethically screened conventional investment) but I don’t think that would be very difficult. Frankly I believe the number should be higher than 10 percent but that’s a good starting point. That requirement alone would create a capital pool of tens of billions of dollars which could be dedicated to affordable housing, microfinance, social enterprise, green energy, etc. And most importantly it would not cost the governments any money.