

# **SOCIAL STOCK EXCHANGES – INNOVATIVE FINANCING FOR INTERNATIONAL DEVELOPMENT By Bandini Chhichhia**

## **I. INTRODUCTION**

“Social finance” is the term that refers to the emergence of a new market paradigm characterised by a range of intricate structures, instruments and players. The phrase denotes a dualistic mode of thinking where traditional economic principles are employed to work in tandem with social and environmental objectives. Recently, its growth has been viewed as “a parallel social economy with its own insitutional and governing structures.”<sup>1</sup>

An important new structure in this landscape of social finance is the Social Stock Exchange (**SSE**) that currently operates in Brazil, South Africa and soon to open its doors in the United Kingdom, Singapore, India, Portugal and New Zealand. SSEs are trading platforms that allow social businesses to raise capital by attracting ethical investors willing to invest in businesses that have a dual corporate and social mission.

Social finance affects important decisions regarding allocation of capital, growth of new markets, new business structures and new commodities within societies. As this parallel social economy gradually deepens its reach, there are significant questions that remain to be answered.

These questions are as follows: (1) why did SSEs emerge and how do they operate? (2) What are the implications of SSEs for international development financing? (3) Are SSEs an example of the market serving societies or, conversely, are societies now serving markets? This paper aims to examine these issues by undertaking a comparative study of SSEs in South Africa and the UK<sup>2</sup> in part II and then employing the findings reached in part II to answer the remaining questions in the balance of the paper.

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<sup>1</sup> Open Universities, Social Investment Seminars, “Social security exchanges,” <http://www.open.ac.uk/oubs/socialinvestmentseminars/p2.shtml>, accessed on 4 December 2011

<sup>2</sup> Note that South Africa was selected as a basis for comparison as it is the only operating social stock exchange in the traditional sense that stock exchanges are understood. Brazil currently has a stock exchange; however it operates on a different model as a selection platform for development projects. Donors can browse and select projects to fund but cannot offer equity financing for any listed social businesses or projects.

## II. SOCIAL STOCK EXCHANGES

### A. Background

Social Stock Exchanges (**SSEs**) are trading platforms that allow social businesses to raise capital by attracting ethical investors to invest in these niche capital markets. There is no standard definition of “social businesses” per se, but it is widely accepted that businesses that have a social, environmental or development focus collectively attract this label. In this paper, the term social business will be used to capture any of these three dimensions of an organisation that engages in achieving both a social objective and financial returns for its stakeholders. However note that businesses with an environmental focus were rarely discussed in the literature to date, so the inclusion of such entities is trajectoryal. A review of social businesses in both the UK and the USA demonstrated that a demand for increased capital was the single common factor that hindered growth of social businesses in both countries.<sup>3</sup> Social entrepreneurs were reluctant to approach traditional capital markets due to the following factors: loss of ownership control, loss of social mission, short term speculation of securities and failure of the market to understand the entity’s intrinsic social value.<sup>4</sup> The latter also led to a related belief that due to this pervading valuation problem, social businesses would be judged poorly based on their relatively lower financial returns compared to their counterparts listed on traditional stock exchanges.<sup>5</sup> These issues along with the growth of social businesses globally brought to bear the vision of SSEs that would operate separately within a new social investment market with its attendant actors: social businesses, ethical investors, specialised intermediaries and government that would understand and value social businesses adequately<sup>6</sup>, Mark Campanale, the director of UK’s SSE posits that “SSE will be a place where social mission can be built irrevocably into the DNA of both the marketplace itself and the corporations that trade there.”<sup>7</sup>

Ideally SSEs aim to service small to medium sized social businesses that are seeking to scale up their operations but are finding it difficult to raise the requisite equity from traditional markets. The following diagram is useful in understanding the typical life cycle

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<sup>3</sup> Linda Rottenberg. "Growing Opportunity: Entrepreneurial Solutions to Insoluble Problems," Scholl Foundation, Sustainability 2007 report (2007), [http://tidescanada.org/wp-content/uploads/files/causeway/Growing\\_Opportunity.pdf](http://tidescanada.org/wp-content/uploads/files/causeway/Growing_Opportunity.pdf), accessed on 7 December 2011

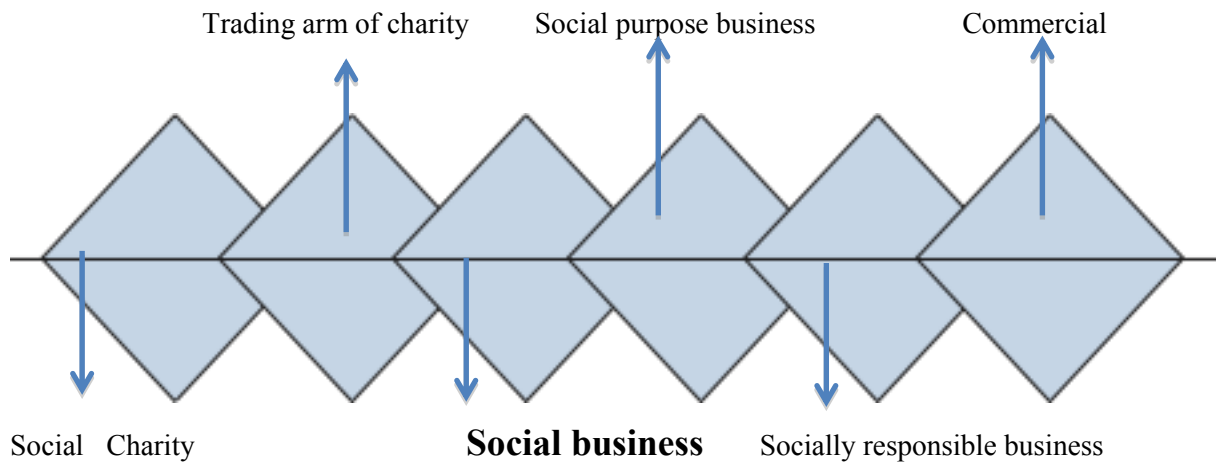
<sup>4</sup> New Economics Foundation, “Developing a Social Equity Capital Market” (2006), [http://www.neweconomics.org/sites/neweconomics.org/files/Developing\\_a\\_Social\\_Equity\\_Capital\\_Market.pdf](http://www.neweconomics.org/sites/neweconomics.org/files/Developing_a_Social_Equity_Capital_Market.pdf), accessed on 8 December 2011, at 19 - 24

<sup>5</sup> Ibid

<sup>6</sup> Omid M., “Throwing money at problems and getting money back,” *Financial News*, 2 March 2011, <http://www.efinancialnews.com/story/2011-03-02/throwing-money-at-problems>, accessed on 7 December 2011

<sup>7</sup> Campanale M., “Bring on the Social Stock Exchange,” *Philanthropist News Digest*, Alliance@PND, 22 July 2010, [http://foundationcenter.org/pnd/alliance/alliance\\_item.jhtml?id=301800013](http://foundationcenter.org/pnd/alliance/alliance_item.jhtml?id=301800013), accessed on 7 December 2011

of a social business that may have started its operations as a charity or foundation but has transformed into a more commercialised structure over time.<sup>8</sup>



**Figure 1 -**



**Typical life cycle of Social Businesses**

The main rationale underlying SSEs was to inject equity into these midsize entities that have matured to the level of a social business, without them having to approach traditional equity markets or private donors for their long term financing needs. The latter methods incur high transaction costs, perpetuate uncertainty and almost always involve a trade-off between social mission and financial returns in the case of traditional equity markets. It is interesting to note that the demand for SSEs was primarily driven by the sector itself i.e. social businesses and entrepreneurs, and then secondary players such as specialised investment firms and fund managers who invest in such companies. With this background in mind, let us examine the current state of SSEs globally to gauge the extent to which this phenomenon has materialised in the real world.

## **B. SSE - a global outlook**

### *i. United Kingdom*

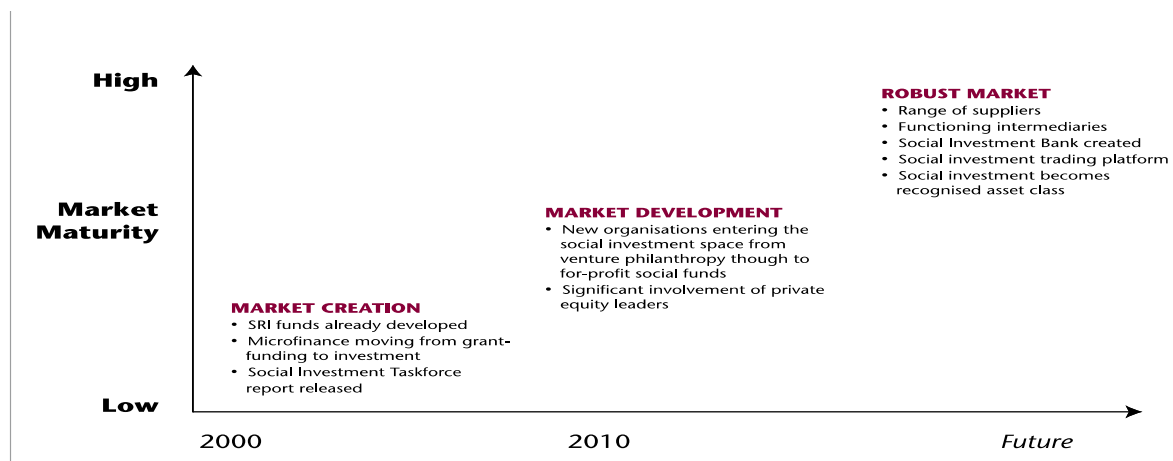
In the UK, the SSE idea germinated from the Report of the Social Investment Taskforce (SITF) called “*Enterprising Communities: Wealth beyond welfare*.”<sup>9</sup> This report was commissioned to discover “how entrepreneurial practices could be applied to obtain higher social and financial returns from social investment, to harness new talents and

<sup>8</sup> Note 4 supra, at 6

<sup>9</sup> Social Investment Task Force, “*Enterprising Communities: Wealth beyond welfare*”(2000), [http://www.socialinvestmenttaskforce.org/downloads/SITF\\_Oct\\_2000.pdf](http://www.socialinvestmenttaskforce.org/downloads/SITF_Oct_2000.pdf), accessed on 8 December 2011

skills, to address economic regeneration and to unleash new sources of private and institutional investment.”<sup>10</sup>The SITF comprised of a diverse range of stakeholders from public, private, philanthropic entities to independent think tanks and investment firms. Over the last ten years, the SITF commissioned two further reports in 2003 and 2005 culminating in its Final Report in April last year.<sup>11</sup>

In addition to its primary mandate, the SITF was also to act as a white board for discussions that might lead to growth of the social investment sector as a whole and entrench social investment as “an established asset class”<sup>12</sup> in the country. Therefore the idea of establishing SSEs was discussed in conjunction with other structures deemed necessary for a healthy social investment sector such as a social investment bank. Since its inception in 2000, key factors that drove the debate forward were growth of the social investment sector over the last decade (see figure 2 below) and growth of private charity organisations in the UK (estimated at £6b in 2010.)<sup>13</sup>



**Figure 2 – The UK Social investment sector: an emerging market**

However, despite receiving positive feedback and collaboration from all stakeholders, the SITF identified the following challenges to growing the social sector:

1. *Consistent performance tracking;*
2. *Market definition and structure – ill-defined terminology, common metrics and key organisations, including advisory or corporate finance functions, specialised*

<sup>10</sup> Ibid, at 2

<sup>11</sup> Final Report of the Social Investment Task Force, “Social Investment Ten Years On”(2010), [http://www.socialinvestmenttaskforce.org/downloads/SITF\\_10\\_year\\_review.pdf](http://www.socialinvestmenttaskforce.org/downloads/SITF_10_year_review.pdf), accessed on 8 December 2011

<sup>12</sup> Ibid at 21

<sup>13</sup> Id. at 6

investment banking and effective secondary markets;<sup>14</sup> and

3. *Valuation* - inadequate standards for measuring social impact against performance benchmarks over the life of a social business.

One might add that accurate valuation not only poses an intertemporal problem with respect to each social business in isolation, but there are also profound valuation difficulties *between* social businesses. The value attributed to any particular business will be influenced by potential investors' politico-moral preferences and the prioritization of the needs of certain interest groups over others. The above considerations apply equally to the specific question of establishing SSEs. Moreover, the following factors were identified as relevant to SSEs by commentators:

1. *Accreditation process;*
2. *Rating agencies;*<sup>15</sup>
3. *Legal issues;*
4. *Remuneration of key personnel to ensure it is creating real value for investors.*<sup>16</sup>

The above issues cumulatively have stalled progress and the original momentum for establishing SSEs in the UK such that the original commencement date of October 2011 has now been shifted to early 2013.<sup>17</sup> Once it commences, UK's SSE will be the first of its kind in the northern hemisphere. However let us turn to a country in the south to see the bustling activity that is already occurring there.

## *ii. South Africa*

South Africa has taken a pioneering stance towards the issue of tackling social development and currently boasts the world's first SSE that opened its virtual doors in 2006.<sup>18</sup> The exchange is called "South Africa Social Exchange" or SASIX, that offers ethical investors a platform to buy shares in social projects according to two classifications: by sector and by province. The sectors currently offered on SASIX are:

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<sup>14</sup> Ibid, at 9

<sup>15</sup> Yunus M., "The Nobel Peace Prize: Nobel Lecture," 13 *Law & Business Review of the Americas* 267 (2006), at 273

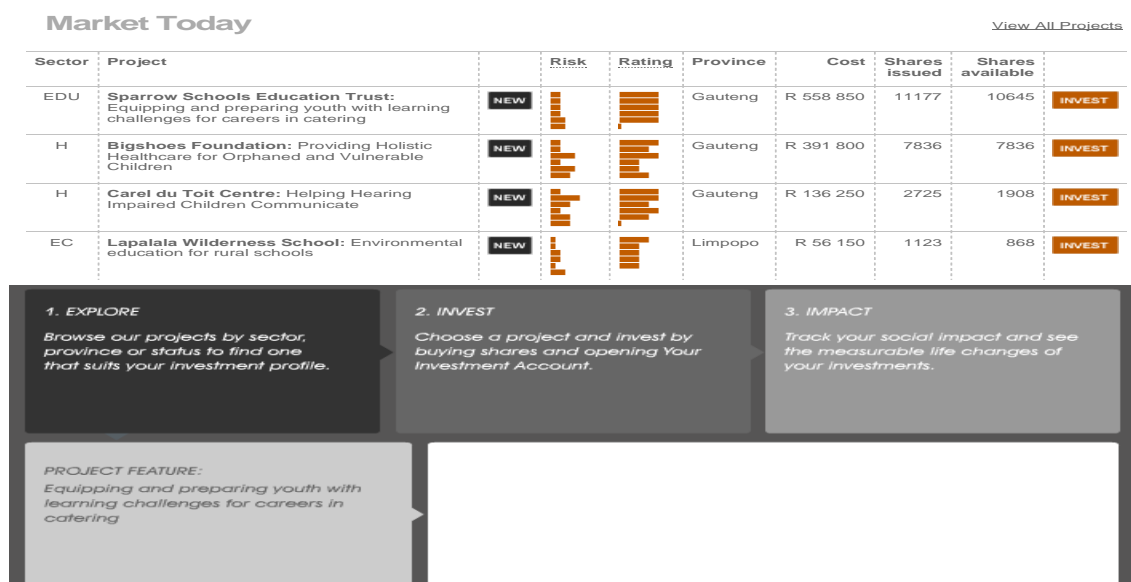
<sup>16</sup> Egan, D. "Time for a stock exchange with a real social purpose," *The Guardian UK*, 19 October 2011 - <http://www.guardian.co.uk/social-enterprise-network/2011/oct/19/time-stock-exchange-social-purpose>, accessed on 4 December 2011

<sup>17</sup> Ibid

<sup>18</sup> Paskin J., "Markets with a mission," *ODE Magazine*, May 2009 - <http://www.odemagazine.com/doc/63/markets-with-social-mission/>, accessed on 5 December 2011, however as noted above, the Brazilian SSE pre-dates SASIX but functions differently from a standard stock exchange.

- i. Food Security and Agriculture
- ii. Small Business Development
- iii. Vulnerable People
- iv. Animal Protection
- v. Education
- vi. Health
- vii. Environment and Conservation<sup>19</sup>

The provinces where the social projects are located are Eastern State, Free State, Gauteng, Kwazulu-natal, Limpopo, National, North West, Northern Cape and Western Cape.<sup>20</sup> Figure 3 provides a snapshot view of a typical day's activity on SASIX.



**Figure 3 – a daily snapshot of SASIX**

Similar to the UK, the impetus for the idea of a social sector grew from the perception that social enterprises are more efficient in delivery of services over conventional actors such as government, charities and NGOs. The government strongly supports the notion of a “social economy” and has set in place structures to support its growth both at the policy and institutional level.<sup>21</sup> There is a listing framework under the Broad-based Black Economic Empowerment (BB-EEE) regulations and amendments to its tax legislation that offer incentives to social enterprises.<sup>22</sup> The next stage of policy reform is intended to consolidate

<sup>19</sup> South Africa Social Stock Exchange, SASIX - <http://www.sasix.co.za/>, accessed on 7 December 2011

<sup>20</sup> Ibid

<sup>21</sup> Tshikululu Social Investments, “Social Enterprise Development in South Africa - creating a virtuous circle,” [http://www.tshikululu.org.za/media-centre/document-archive/wp-content/uploads/2010/09/TSI\\_research\\_social-enterprise\\_2010.pdf](http://www.tshikululu.org.za/media-centre/document-archive/wp-content/uploads/2010/09/TSI_research_social-enterprise_2010.pdf), accessed on 8 December 2011, at 3

<sup>22</sup> Ibid

the taxonomy that exists at the BB-EEE listing level so that the different labels of “enterprise development” and “corporate social responsibility” can be incorporated under the broader umbrella of “social enterprises.”<sup>23</sup>

However before conducting any meaningful comparison there are a few definitional issues that need clarification. Social businesses are referred to as “social enterprises” in South Africa. A working definition of a social enterprise was adopted at a National Conference on the enabling environment for social enterprise development in South Africa, hosted by the ILO in October 2009 as follows:

*“A social enterprise’s primary objective is to address social problems through a financially sustainable business model where surpluses (if any) are mainly reinvested for that purpose”<sup>24</sup>*

Even a cursory perusal of this definition implies that it contains several elements that could prove problematic to implement in practice. First, how does one prove that the business has a primary objective that is social and not financial; what if they are equally balanced? In practice, though there may be arguments as to the relative importance of different objectives in particular cases, all legal systems are accustomed to formulating and applying tests of primary or dominant purpose. Secondly, how does one enforce the criterion that “surpluses are reinvested for social purposes” in the business? Decisions regarding capitalisation must be made having regard to an entity’s capital requirements at a particular point in time as assessed by the board of directors. So to impose this second criterion is potentially burdensome and might impinge on prerogatives normally conferred to corporate boards. But this should not present an insurmountable difficulty. There have long been company law rules, which restrict or preclude distributions in certain circumstances, whether by way of returns of capital or dividends out of profit, and which also regulate the method by which distributions are made to particular (e.g., preference) shareholders.

Commentators have noted a number of prominent factors that SASIX looks for when screening social businesses for accreditation and listing, which include the following:

- i. a primary social purpose;
- ii. a financially sustainable business model; and

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<sup>23</sup> Id., at 13

<sup>24</sup> Note 21 supra

- iii. accountability and transparency mechanisms.<sup>25</sup>

SASIX has thus not allowed itself to be hamstrung by definitional issues. The listing criteria have been further refined over time and are now quite specific, with additional factors as:

- iv. specific, development interventions addressing an identified need within a community (preferably targeting at least one of the 22 identified Presidential Poverty Nodes);
- v. clear, measurable deliverables;
- vi. past track record of similar projects;
- vii. a budget that focuses primarily on the intervention reaching beneficiaries;
- viii. project control by registered non-profit organisations (SASIX itself is a so-called 18A registered Trust in South Africa); and
- ix. conformity with SASIX's good practice guidelines for each sector.<sup>26</sup>

The South African approach differs from UK's "balanced" model. The former reflects a stronger form of the "primary purpose" test, whereas the latter is more receptive to the proposition that a social business may balance its social mission with commercial activities. In addition to the government, there are a range of other actors that provide financial support and/or technical assistance to social entrepreneurs, social enterprises and investors. Briefly the international actors are the Schwab Foundation, Ashoka, World Bank Institute and Aspen Network of Development Entrepreneurs. The domestic actors are *ILO – SETYSA*, African Social Entrepreneurs Network and local universities that provide courses, training and mentoring support.<sup>27</sup>

Going forward, there are proposals to develop a pool of intermediaries and products that can link investors with appropriate social enterprises and establish a Risk Guarantee Fund to and a Social Enterprise Fund "to provide capital specifically for social enterprises."<sup>28</sup> The South African Minister of Economic Affairs, Ebrahim Patel, announced that a percentage of pension fund investments would be earmarked for social investment proving a potential R70 billion pot for social businesses.<sup>29</sup>

The above developments are analogous to concerted efforts in the UK, aimed at growing the social economy. There is one important distinction in South Africa's approach that

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<sup>25</sup> Ibid, at 5

<sup>26</sup> South Africa Social Stock Exchange, Guidelines for listing [http://www.sasix.co.za/about\\_us/requirements\\_for\\_listing\\_/guidelines\\_for\\_listing/](http://www.sasix.co.za/about_us/requirements_for_listing_/guidelines_for_listing/), accessed on 7 December 2011

<sup>27</sup> Id., at 8 - 9

<sup>28</sup> Id., at 13

<sup>29</sup> Id.



deserves mention. The policy debates in South Africa chiefly occur under the rubric of “access by social enterprises to affordable finance.” This seemingly innocuous phrase has wide repercussions at the status level. The terminology of “access” implies that there is a threshold acceptance of social businesses in the country and thus the need for additional equity capital is a “right” that these new entities are entitled to. In this respect, the South African discourse is far ahead of the debates occurring in the UK, which still focus on how to classify, and hence accept, social businesses as economic agents in the market.

### C. Summary

Looking at the developments in both countries there are a number of lessons that can be drawn from each. In the case of South Africa, the launch of SASIX has revolutionised the way philanthropy is perceived and conducted in the country. As Paskin contends, “what these [SSE] efforts share is a commitment to the language and practice of the business sector such that the language and practices of the business world would take [SASIX] into new territory.”<sup>30</sup> And this is the key. For the first time, philanthropy has progressed from the domain of pure altruism to a relationship of ownership, such that donors are now owners of social businesses with a vested interest in their commercially viable performance.

The second advantage, which the UK is still grappling with, is the use of common terminology. Insofar as common definitions, standards, metrics and values reflect both social objectives and financial performance (which the market and investors are well acquainted with), social businesses can garner greater engagement from investors. In this sense, SASIX has provided a new *lingua franca* for actors in the social economy. This is also envisaged for the UK as Campanale states “hopefully, the SSE will allow [social business] entrepreneurs to realize their dreams, working with like-minded bankers and investors who share their hopes and goals.”<sup>31</sup>

Both countries intend to expand their social finance sector and there is an underlying belief that “the huge social challenges, that threaten the cohesion of society, cannot be addressed by government or the private sector alone.”<sup>32</sup> Interestingly, given the anti-market sentiment following the global financial crisis and populist movements such as the Occupy Wall Street protests, SSEs might provide a fresh legitimacy and utility for certain market-based practices. As Egan contends, “the global financial crisis has had many negative effects but it has also provided a golden opportunity for social enterprises to move into the centre

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<sup>30</sup> Note 18 supra

<sup>31</sup> Note 6 supra

<sup>32</sup> Note 10 supra, at 9

of the financial system and reboot it from within.”<sup>33</sup> So how do the domestic movements in these two countries affect the world of international development? The SITF report concluded that, “developments in the UK are part of an international process of innovation in dealing with social issues.”<sup>34</sup> This implies that financing for international development was at the heart of deliberations that occurred over the last decade. Augmenting this view is Campanale’s last public statement where, in response to a question about the future of a UK SSE, he replied that:

“I would hope [that the future is] one where ventures from the global South that have in the past been wholly reliant on philanthropic donations will create viable, scaleable businesses that are attractive to for-profit social investors in the North.”<sup>35</sup>

And this is where the North-South and potentially, international development link is established. Despite its original focus on domestic social issues, SSEs have the potential to offer the same benefits to social businesses in developing countries. It is a new instrument in the toolkit of innovative financing within the international development architecture.

### **III. IMPLICATIONS FOR INTERNATIONAL DEVELOPMENT FINANCING**

#### **A. Innovative financing for development**

##### *i. What is innovative financing for development?*

Innovative financing involves risk mitigation and credit enhancement through the provision of collateral. It is also generally seen as including a diversification component in which risk is spread amongst many investors and guaranteed by higher rated third parties. It is not limited to financial engineering.<sup>36</sup> In the international development sphere, Yunus proposes that the concept embraces methods which bridge the resource gap by the recasting of successful financial instruments well-understood by the private sector in a manner that facilitates development objectives.<sup>37</sup>

At the international level the issue is of high importance as the United Nations established the “Leading Group on Innovative Financing for Development”<sup>38</sup> in 2006 with the objective

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<sup>33</sup> Ibid

<sup>34</sup> Note 10 supra, at 13

<sup>35</sup> Note 6 supra

<sup>36</sup> Ketkar S., Ratha D., “Innovative Financing for Development” (2008) World Bank Publications, at 20

<sup>37</sup> Yunus M., “More Health for Money,” *Busanovate* (blog), Devex - <http://www.devex.com/en/articles/more-health-for-the-money-3>, accessed on 8 December 2011

<sup>38</sup> MDG Gap Task Force Report, United Nations, “Global Partnership for Development at a critical juncture,” (2010),

to “conceive, study and promote new mechanisms intended to complete traditional development aid by bringing in new, stable and predictable resources.”<sup>39</sup>

Recently, the issue took great prominence at the Fourth High Level Forum on Aid Effectiveness in Busan where the private sector had a seat at the table. Importantly, it was identified as a key building block for the forum and all attendees had a specific mandate to discuss ‘joint innovation’ under this building block. The deliberations under this building block were translated into clause 32 of the Working Document after the forum. Clause 32 stipulates:

***Private sector and development***

*32. We recognise the central role of the private sector in advancing innovation, creating wealth, income and jobs, mobilising domestic resources and in turn contributing to poverty reduction.*

This is a highwater mark for the private sector as it is now permanently woven within the international development architecture for all future development efforts, along with traditional actors such as states, intergovernmental organisations and NGOs.

The principal reason why the private sector has been brought to the forefront of international development has been the global financial crisis and its negative impact on official development assistance from states. The OECD Development Aid Committee noted that private capital flows from its members to developing countries between 2000 and 2009 were more than double bilateral Official Development Assistance (**ODA**) during this period (57 versus 27 percent).<sup>40</sup> It is currently 13 percent of total capital flows moving to developing countries.<sup>41</sup> The Committee further projected that the next five years will see a leveling off ODA. Hence the impetus to find ways “to stretch the ODA dollar, and to combine it with private sector resources.”<sup>42</sup>

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[http://www.un.org/en/development/desa/policy/mdg\\_gap/mdg\\_gap2010/mdg8report2010\\_engw.pdf](http://www.un.org/en/development/desa/policy/mdg_gap/mdg_gap2010/mdg8report2010_engw.pdf), accessed on 8 December 2011

<sup>39</sup> The Leading Group on Innovative Financing for Development was conceived after the 2005 Paris Conference and currently comprises of 55 member countries, 5 observer countries, 16 inter-governmental organisations and a number of key non-governmental organisations and networks - <http://www.leadinggroup.org/article955.html>, accessed on 8 December 2011

<sup>40</sup> Coleman I., “The Convening power of traditional donors,” Devex, 7 December 2011 - [http://www.devex.com/en/articles/the-convening-power-of-traditional-donors?source=DefaultHomepage\\_Center\\_1](http://www.devex.com/en/articles/the-convening-power-of-traditional-donors?source=DefaultHomepage_Center_1), accessed on 8 December 2011

<sup>41</sup> Gross K., “Busan reflectios: Optimism and Ownership at HLF4” Devex, 8 December 2011 <http://www.devex.com/en/articles/Busan%20Reflections:%20Optimism%20and%20Ownership%20at%20HLF4>, accessed on 12 December 2011

<sup>42</sup> Atwood B., “The Source of Innovation,” *Busannovate* (blog), Devex, 18 November 2011 - <http://www.devex.com/en/articles/the-source-of-innovation>, accessed on 8 December 2011

There has been a trend in the last ten years to form hybrid entities that focus on a common development issue, such as health. Examples of such public-private partnerships are GAVI that created the International Finance Facility for Immunization (IFFIm) and the Global Fund to fight HIV/AIDS, Tuberculosis and Malaria, that pools resources from multiple donors to fund its operations. The IFFIm sells bonds on capital markets that are backed by the long-term commitment of a few donor countries.

The next wave of innovation seems to point towards the growth of social businesses and impact investing. The key proponent for social businesses is the pioneering social entrepreneur, Muhammad Yunus<sup>43</sup> who created the Grameen Bank.

### **B. Social businesses and SSEs – a conceptual framework**

Yunus provides a compelling case for social businesses. He starts from the premise that the current capitalist framework is inaccurate and represents a “half-built structure.”<sup>44</sup> He supports this argument using Adam’s Smith’s doctrinal works: the seminal *Wealth of Nations* and the *Theory of Moral Sentiments*. He posits that present day economic theory is skewed such that it is based solely on market dynamics first enunciated in the *Wealth of Nations* by Smith. He asserts that the present day market structure is a projection of intrinsic values of profit-maximisation, self-interest and on an individual level, selfishness. He proposes a counterargument against this classical economic model stating that markets are ultimately a representation of human beings and societies, which are inherently multi-dimensional in nature.<sup>45</sup> Therefore, to have a model that is singular and blinkered, such as the current one, is an anomaly. He supports this argument using the *Theory of Moral Sentiments* where Smith himself acknowledged the value of non-economic characteristics such as justice, moral virtues and altruism, collectively bringing them under the umbrella of “sympathy.”<sup>46</sup> This is the strength of his theory as it adopts a historical counterargument against pure capitalist markets that were promulgated on the basis of the invisible hand. On a practical level, in light of the global financial crisis and now the burgeoning debt crisis facing the European Union, his theory is also attractive at the grassroots level given the growing discontent with pure markets and capitalism.

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<sup>43</sup> Yunus M., “Economic security for a world in crisis” *World Policy Journal* 1 (2009)

<sup>44</sup> *Ibid*, at 8

<sup>45</sup> *Id.*

<sup>46</sup> *Id.*

So following from this need to encompass “sympathy” within traditional economic theory, he proposes a workable model for the future i.e. social businesses, which he calls the “missing element.”<sup>47</sup> However, the caveat here is that the way in which he defines social businesses is markedly different from the definition that is gaining traction at the policy tables of most governments. According to Yunus -

*“A social business is one whose purpose is to address and solve social problems, not to make money for its investors. It is a non-loss, non-dividend-paying company ... These profits remain with the company and are used to expand its outreach, to improve the quality of the product or service it provides, and to design methods to bring down the cost of the product or service.”<sup>48</sup>*

In this regard, his definition is closer to the South African working definition rather than the one adopted by SITF in the UK. Yunus believes that the *raison d’être* for social businesses should be the achievement of their social objectives subject to the condition that they are financially sustainable entities that follow the three corporate commandments of good governance, transparency and accountability. Thus, all revenues should be ploughed back into the business so that the entity can expand its reach - geographic or product range. Thus, he implicitly rejects the bifurcation of corporate motives, as is suggested by the social business definition by the SITF in the UK instead adopting a purist version of that term. He justifies re-investment of profits on the basis that the fundamental goal of all social businesses is to bring down the costs of the relevant product or service.

So despite the commonality of creating a parallel economy, this distinction is an important one. What is unique is the fact that Yunus is the first theorist that has married the idea of social businesses to international development and provided a practical framework for the future. Given his success with starting the microfinance industry in Bangladesh, his ideas have gravitas.

With respect to international development, he proposes that bilateral and multilateral donors can support economic development by creating social businesses.”<sup>49</sup> His rationale is that since the social business model demands that the company generate ongoing revenues through its activities to be sustainable (for example, by charging tolls or usage fees on its bridges), the initial grant would lead to “a continuing, ever-replenished revenue stream,

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<sup>47</sup> Note 41 supra, at 9

<sup>48</sup> Ibid

<sup>49</sup> Id., at 11

ultimately producing more social bang for the donor's buck."<sup>50</sup> Further, since the money is continually being recycled, the social impact could be that much more powerful. Here, he draws an analogy with traditional capital markets that facilitate growth of businesses.<sup>51</sup>

From a macro perspective, he argues that it is widely accepted that there is a current resource gap to address the prevailing development issues facing the world.<sup>52</sup> So by investing in social businesses now, donors are actually mitigating the future resource gap because the compounding effect of each aid dollar maximises the total value of donor aid over time.<sup>53</sup> From the beneficiaries' perspective, this provides a more predictable and stable source of funding where over time "donor dependence can be minimized."<sup>54</sup>

He connects this idea to his vision of creating a wide pool of equity available to social businesses where potential funding could come from any of the traditional sources (donors states, international organisations, private sector and NGOs).<sup>55</sup>

He bolsters his idea of increasing aid funding for social businesses by contending that social businesses inherently possess a greater capacity "to innovate, expand and reach more people through the power of the free market"<sup>56</sup> compared to charities.

Reverting back to the original discussion of innovative financing for international development, social businesses are a new player in the field that may resemble the private sector in some respects but are unique in many others. Figure 4 depicts what the new international development architecture may look like with the growth of social businesses

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<sup>50</sup> Id.

<sup>51</sup> Note 41 supra, at 8

<sup>52</sup> Note 36 supra

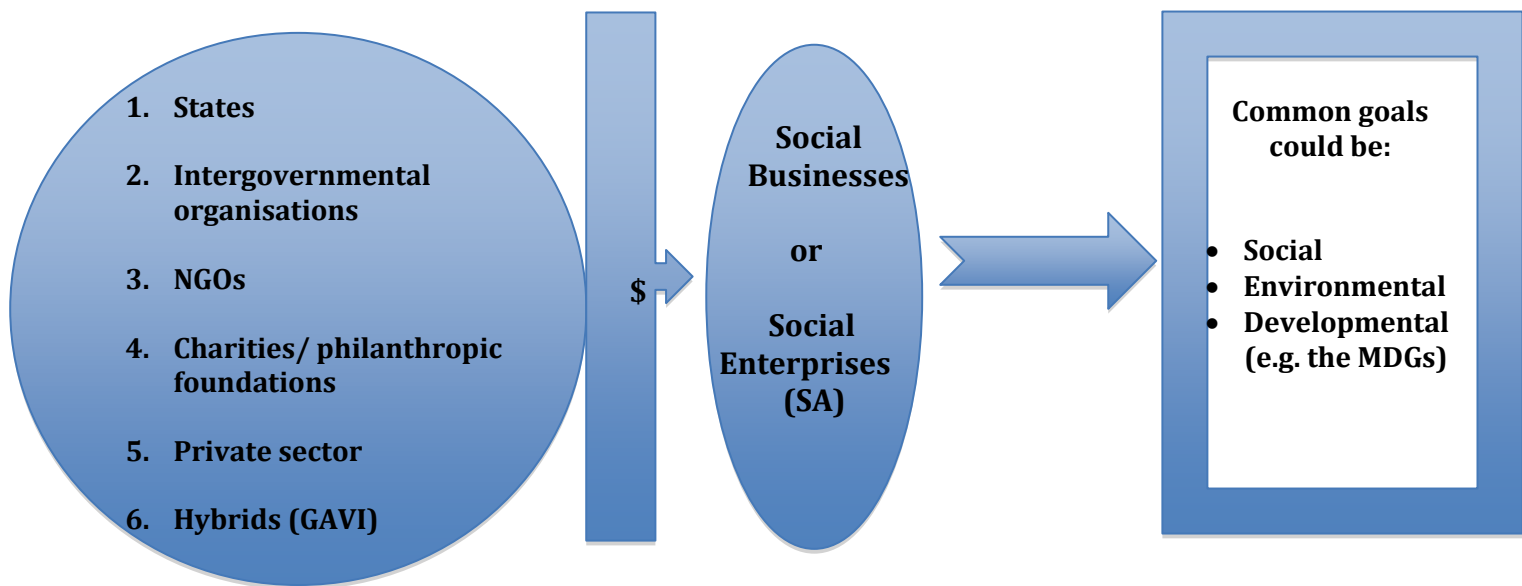
<sup>53</sup> Ibid

<sup>54</sup> Id.

<sup>55</sup> Ibid

<sup>56</sup> Id.

**Figure 4 – The new international development architecture**



As a final link to his theory, Yunus discusses SSEs as a trading platform that would connect investors with social businesses and operate in a similar fashion to traditional stock exchanges (he even suggests creating the Social Wall Street Journal!).<sup>57</sup> Thus, investors “motivated by the desire to promote particular social goals would use this market to channel funds into social businesses that promote these ends.”<sup>58</sup>

So, is he alone in his new approach to tackling development issues? Are his ideas utopian or at best naïve, given the fact that underlying in his social business theory is the proposition that the achievement of common development goals is an apolitical exercise. Even a novice in the field understands that this is far from the truth as the world of international development is a political minefield, leaving aside the experts.<sup>59</sup> Indeed, various criticisms directed at the Grameen Bank, microfinance generally and Yunus personally suggest that different methods of promoting development can incite highly politicized debates.

The notion of global solidarity by multiple actors for the furtherance of development objectives was cohesively put forth by Severino and Ray in albeit different terminology.<sup>60</sup>

<sup>57</sup> Note 41 supra, at 12

<sup>58</sup> Ibid

<sup>59</sup> David Kennedy, *The "Rule of Law," Political Choices, and Development Common Sense* in THE NEW LAW AND ECONOMIC DEVELOPMENT: A CRITICAL APPRAISAL 95 (David M. Trubek and Alvaro Santos, eds.) at 167 - 72

<sup>60</sup> However note that other authors (such as Willy Brandt in *North-South: a program for survival*, 16 MIT Press, 1980) before them did speak about the need for greater global solidarity, nevertheless Severino and Ray are the first to provide a comprehensive framework for such solidarity within the international development architecture.

They argued that the traditional concepts of ODA and hence its measurement was archaic given the “seismic changes”<sup>61</sup> in three key areas of international development - goals, actors and instruments.<sup>62</sup> They were wary of using the term “innovative development finance” since they were proposing a different measuring index – “Global Policy Finance.”<sup>63</sup> Despite these varying terms, their underlying theory and arguments directly bear upon the social business model propounded by Yunus.

Severino and Ray argue that after the fall of the Berlin wall, international development assistance needed a new conceptual framework for its continual legitimacy, since financing for geopolitical advantage was now deemed unnecessary.<sup>64</sup> This gave rise to the notion of “compassionate ethics” where aid was granted to solve specific development issues, initially to avoid natural disasters and humanitarian crises.<sup>65</sup> Subsequent to this shift in policy was a reduction in ODA and a resource gap for key development issues that were previously the domain of states only.

A new paradigm emerged to fill this conceptual void where development objectives were now perceived as universal “global goods” that every human being was entitled to. Hence, the responsibility to finance and protect these global goods fell on every global citizen instead of traditional actors. This conceptual shift led to the introduction of new actors such as philanthropic entities and the private sector to create a greater pool of resources to minimise the gaping resource gap. They posited that if development goals are global goods to be achieved, then it was logical for all actors to devote their resources towards strengthening the “weakest link,”<sup>66</sup> since that affected the strength of the whole chain or the overall quality of the global good at any point in time.

Within this new backdrop of a different global public policy, they contended that innovations by the private sector were particularly instrumental in ensuring that development aid moved beyond the “logic of one-off projects to seek more systemic

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<sup>61</sup> Severino J., Ray O., “The End of ODA: Death and Rebirth of a Global Public Policy,” Centre for Global Development, Working Paper Number 167 (March 2009) at 7

<sup>62</sup> Ibid at 3

<sup>63</sup> Id. at 8, the authors use a new term “Global Policy Finance” as they believe that the “instrumental revolution is often referred to as ‘innovative development finance’ – improperly, as these innovations are not exclusively financial, and as they do not only deal with ‘development’,” see specific discussion of Global Policy Finance at 16 - 25

<sup>64</sup> Note 58 supra at 3, But it must be said that the activities of China in Africa and of the USA/UK in many regions of the world illustrate that it would be naïve to suppose that the use of aid for geopolitical purposes ended with the Cold War and the current debates in Busan were a testament to the birth of renewed interest in geopolitical aid.

<sup>65</sup> Ibid

<sup>66</sup> Note 58 supra at 11



effects.”<sup>67</sup>From a beneficiaries’ perspective this proliferation of actors had a number of advantages such as: a greater menu of development financing removed from hidden geopolitical considerations, long term financial sustainability and reduced conditionality. They concluded that, “official development flows have moved beyond the logic of economic investment to include one of long-term social redistribution.”<sup>68</sup>

Insofar as investing in social businesses is concerned, they called it “socially responsible investing or ethical finance” where recurrent private financing sources would find recurrent uses in international development.<sup>69</sup> This is the same as impact investing as it is presently understood and in Yunus terms is the same as the recycling effect of aid that creates recurrent (albeit different) development uses for the same aid dollar.

### C. The third sector

I have examined the growth and perceived benefits of social businesses and SSEs. I have also examined two modern theories that aim to legitimise these emerging phenomena. But given the scepticism surrounding pure market ideology, highlighted by the largesse of recent market failures, can we really trust the market or its instruments (such as social businesses and SSEs) to deliver social goods, both at the domestic and global level? And if a dualistic business model, such as the one proposed in the UK is eventually adopted, can such a hybrid structure deliver both financial returns and social objectives for investors?

These questions require probing deeper into the current market structure to understand how markets fit within societies. The theorist who elegantly unites the work of Yunus and Severino is Karl Polanyi. His doctrinal work *The Great Transformation* provides a persuasive historical perspective to the current debates and the role of SSEs.

He scrutinises the free market economic model and neoliberal economic theory that emerged after the industrial revolution of the 19<sup>th</sup> century on the basis of historical legitimacy. He attacks the prevailing economic model on the premise that it is historically, anthropologically and culturally inaccurate, and is thus a misrepresentation of how markets should function within societies. A key term in his thesis is “embeddedness,” which expresses the idea that “the economy is not autonomous, as it must be in [classical]

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<sup>67</sup> Note 58 supra at 13

<sup>68</sup> Ibid at 15

<sup>69</sup> Id. at 9, table 1

economic theory, but sub-ordinated to politics, religion and social relations.”<sup>70</sup>This in particular resonates with Yunus’s arguments about skewed economic modelling and the absence of “sympathy” in the current market structure.

Polanyi goes further and examines the dynamics between markets, society and nature. He argues that if markets were to assume a self-regulating pedestal role above society and nature, then this would ultimately lead to “disembeddedness” where human beings and nature are commoditised and reduced to fit within the logic and discipline of markets. He states that, “in this sense, one might say that disembedding the market is similar to stretching a giant elastic band. Efforts to bring about greater autonomy of the market increase the tension level ... representing social disintegration.” A sombre warning to present day problems, that went largely unheeded.

He is often misunderstood as a theorist oscillating between binary versions of socialism and capitalism. On the contrary, Polanyi envisaged a spectrum of economic behaviour in between these two options,<sup>71</sup> proposing a role for “markets within societies to provide social goods.”<sup>72</sup>If Polanyi was still alive, he may have used the term “the third sector” as it is now used to represent the social sector or the “missing element,” as Yunus coins it.

But is his theory purely domestic and hence irrelevant to our analysis of international development? Strikingly not - the global economy was at the heart of his thesis.<sup>73</sup>He transposes the notion of disembeddedness leading to social disintegration at the global level, citing loss of international security and peace as the product of such disintegration. Similarly, Yunus<sup>74</sup> and Severino<sup>75</sup> voiced similar concerns when discussing the need for greater international solidarity and a different paradigm for international development.

Perhaps Polanyi saw into the crystal ball 50 years ago as he concludes his work by saying that “the alternative [to free markets] is that ordinary people in nations around the globe engage in efforts to subordinate the economy to democratic politics and rebuild the global economy on the basis of international co-operation.”<sup>76</sup>This is a Eureka moment as

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<sup>70</sup> “Foreword,” Joseph Stiglitz (2001), in Karl Polanyi (1944) “The Great Transformation” Boston: Beacon Press: vii-xvii

<sup>71</sup> Ibid, at xxviii

<sup>72</sup> Note 67 supra, at xxxvii where he cites an example of Scandinavian countries and their social welfare model

<sup>73</sup> Ibid, at xxix

<sup>74</sup> Note 41 supra, at 7

<sup>75</sup> Note 58 supra, at 12

<sup>76</sup> Note 67 supra, at xxxvii

reviewing the growth of actors within international development architecture, there is a move towards greater global integration. The economic shockwaves of recent years, and the increase of non-state actors within the international development architecture, have fostered a move towards greater integration across national lines.

Polanyi's idealistic vision of international solidarity at an individual human level will be closer to fruition if people perceive international development issues as global public goods to be protected and financed. As social businesses gain further traction, SSEs could play an important role in facilitating this vision. They are an example of an innovative structural mechanism whereby markets can be adapted to serve the societies within which they operate. Importantly, SSEs differ from traditional market instruments in one crucial way. The financial engineering behind SSEs "has the effect of *correcting* some of the excesses and limits of mainstream markets"<sup>77</sup> instead of perpetuating them.

There are a number of reasons why SSEs can be perceived as conduits with the potential to moderate the relationship between societies and markets. But, the main force of SSEs lies in the fact that they reverse previously held ideologies about conflicting North-South interests. Polanyi foresaw this and contended that, "it will not be easy to form a durable alliance that reconciles the often conflicting interests of people in the global South with those in the global North."<sup>78</sup> SASIX is a classic example of innovative ideas moving from the South to the North, just like how microfinance gained traction after its first project in Bangladesh. Atwood calls the work of Yunus and other pioneers, truly developmental, as these innovations are "inside out" because they create an environment for investment at both the local and international level.<sup>79</sup>

Secondly, SSEs are unique in the sense that they are created outside Polanyi's paradigm of the "double movement" or the giant elastic band where society responds to destructive effects of a market by creating new laws and institutions.<sup>80</sup> SSEs were a response from unconventional actors, private sector and individuals, that saw value in creating the third sector.

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<sup>77</sup> Note 58 supra, at 8

<sup>78</sup> Note 67 supra, at xxxviii

<sup>79</sup> Note 40 supra, this sentiment is also echoed by Ananya Roy in "Poverty Capital – Microfinance and the making of development" (2010) Routledge, chapter 1

<sup>80</sup> Fakhri M., "Law as the Interplay of Ideas, Institutions, and Interests: Using Polyani (and Foucault) to ask TWAIL Questions," 10 International Community Law Review 455-465 (2008), at 459

Thirdly, SSEs and social businesses provide a more nuanced view to the dominant market structure that has prevailed for two centuries. It is important to bear in mind that the current market model is just that, a system (albeit, a very successful one<sup>81</sup>) that was created from an idea accepted by the right interests and institutions of that time.<sup>82</sup> So, I remain sanguine about the fate of SSEs.

#### IV. CONCLUSION

So be it the bustling bazaar of Marakesh or the lightning momentum of the New York Stock Exchange, it is trite to say that the world is morphing into one big market place. The migration of ideas and structures from traditional capitalism into the domain of international development assistance is a timely development. SSEs have the potential to open up a new portal for international development financing by permitting social businesses to sell their “social goods” on a broader common platform<sup>83</sup>. It is essentially no different than the Moroccan merchant who brings his wares to the bazaar knowing that there will be a pool of interested buyers who will pay a price for a product that they value. From a micro level, this is laudable as emerging social businesses (both in the north and south) can create more sustainable business models and easily raise equity from the market. From a macro level, this change captures both the “democratisation of development”<sup>84</sup> and “financialisation of development”<sup>85</sup> as more actors conduct development work using innovative financial instruments. As Severino and Ray contend - “a second Copernican revolution has shaken the field of international development.”<sup>86</sup>

Currently, the main challenges lie in building a critical mass of social businesses that are ‘market ready’ to make SSEs viable, and developing a common terminology and consistent valuation parameters for all players in the field. In this regard greater harmonisation of entrepreneurial know-how from both sides of the globe would assist in building this critical mass. One approach is fragmenting the operations of existing charitable

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<sup>81</sup> Sen A., “Role of Legal and Judicial Reform in Development” Speech at the World Bank Legal Conference, Washington, DC (5 June 2000), at 16

<sup>82</sup> *Ibid*, at 463

<sup>83</sup> See Bebbington and Bebbington, “Development Alternatives: Practice, dilemmas and Theory,” 33 *Royal Geographical Society* 1, (2001) 7 – 17, at 9 where the authors discuss the need for a new paradigm where the market encompasses development initiatives at the grassroots level.

<sup>84</sup> Ananya Roy in “Poverty Capital – Microfinance and the making of development” (2010) Routledge, chapter 1

<sup>85</sup> *Ibid*

<sup>86</sup> Note 58 *supra*, at 5

foundations so that they are part grant-driven and part social business (see for example the model of MicroEnsure.<sup>87</sup>)

There is a possibility that SSEs may encourage competitive tension between participating listed charities and projects in a similar way as the shares of companies listed on a conventional stock exchange. This might be advantageous if it results in a general improvement of service delivery to aid recipients. For instance, a charity that is comparatively inefficient will be relatively less attractive as a funding destination and could be forced to streamline its operating methods. This might be analogised to companies whose shares carry a premium because they implement strong cost control and best practice corporate governance. By the same token, the potential for SSEs to facilitate comparative analysis of development bodies and competition amongst them for donor funds might not be a positive feature in all cases. For example, if a charity compromises on what would otherwise be the most appropriate means of serving the *particular* needs of its beneficiaries because it feels compelled to package those services in a way that favourably compares with rival charities. To some extent, this risk is already present in the informal 'market' for donor funds but may be accentuated in an SSE context.

Finally, having harnessed this unbridled power of the market, an ongoing challenge lies in taming this beast and ensuring that it delivers what it promised to at the outset. This is where proactive governance<sup>88</sup> by both state and international actors comes into play in ensuring that adequate checks and balances are built-into regulatory frameworks as SSEs gain momentum.

However, what is undeniable is that, the invisible hand can have a compassionate touch and the market can in fact be employed to lift the bottom billion from poverty with the hope of a better future in a changing global order.

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<sup>87</sup> Leftley R., "From grants to commercial funding," *Busannovate* (blog), Devex - <http://www.devex.com/en/articles/from-grants-to-commercial-funding>, accessed on 11 December 2011. The article uses the example of MicroEnsure a company that provides low cost insurance to beneficiaries and which was started using a grant from the Bill and Melinda Gates Foundation. MicroEnsure has reached a stage where it services nearly 3 million clients and is contemplating floating the commercial side of its operations, whilst still maintaining the research and development arm as a separate grant driven enterprise.

<sup>88</sup> Nnadozie E., "Innovative Financing for Development: Opportunities and Policy Options for Africa," *Busannovate* (blog), Devex, 28 November 2011 - <http://www.devex.com/en/articles/innovative-financing-for-development-opportunities-and-policy-options-for-africa>, accessed on 8 December 2011. Note that in this respect, even Polanyi foresaw a need for government intervention (at both the domestic and international level) to promote the correct positioning and function of markets, see note 67 at xxxv - xxxvi

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