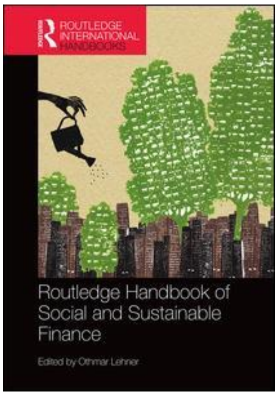

Routledge Handbook of Social and Sustainable Finance

Othmar M. Lehner

The Architecture of Social Finance

Publication details
https://www.routledgehandbooks.com/doi/10.4324/9781315772578.ch3
Gadaf Rexhepi
Published online on: 30 Jun 2016

3
THE ARCHITECTURE OF SOCIAL FINANCE

Gadaf Rexhepi

Research shows that while donations are increasing, donors are actually on the decline (Strandberg, 2006). Charity organizations are financed mainly by governments (about 80 percent) and by other sources like grants, sponsorships, donations, etc. This is the case of many important charity organizations, the oldest of which is the Benevolent Society, with an income of more than $80 million per annum, 82 percent of which coming from government sources (Tamás & Sato, 2012, p. 13). But what if governments, for some reason, fail to deliver grants to charity organizations? Will these charities continue to exist? What will happen to those who are in need then? social finance as a concept proposes a different way of dealing with poverty.

Bill and Melinda Gates are among the best known philanthropists in the world. In 2012, they gave away $3.4 billion. They also declared they will continue to give away a big portion of their wealth in the next years. Considering that their current fortune is about $77 billion and still growing, this will be a huge amount of money. Warren Buffet has also given away huge amounts of money and has pledged to donate 99 percent of his wealth. There are also a lot of other wealthy people and government organizations that are helping others and this is great, but will this solve the problem of poverty all around the world? Let me raise a hypothetical question: if all billionaires decided to give away 80 percent of their money to charities, will this eradicate world poverty? This money will be given mainly to charity organizations which will then deliver to those in need, solving the problem for some people for some years. But would it help solve the problem forever? Unfortunately, this will not be enough, mainly because of the way the money is spent.

A great way to deal with this problem is with "social finance," which is designed to help economies by providing situations where everybody will benefit. Social finance today has gained a huge interest, becoming an often discussed topic in conferences, seminars, research journals, universities, governments, municipalities, publishing, etc. Studies show that after the recent financial and economic crises, many financial organizations are pressuring corporate executives to provide reports for their non-financial performance (Cho, Lee, & Park, 2012, p. 54). This means that organizations should step up in motivating their employees, which is one of the main goals of social finance—to strike a balance between organizational profit (moderate) and employee motivation. According to a survey done by JP Morgan and the Global Impact Investing Network (GIIN) in November 2010, the US market comprises an estimated $183 billion to $667 billion, with invested capital in the range of $400 billion to nearly

$1 trillion (O'Donohoe, Leijonhufvud, Saltuk, Bugg-Levine, & Brandenburg, 2010). In May 2009, US President Barack Obama created a $50 million Social Innovation Fund and a new White House office that will coordinate the fund's efforts (Mair & Ganly, 2010, p. 103). The amount invested by the 125 leading Impact Investors in social finance is expected to grow by nearly 20 percent this year, according to the latest study by the GIIN and JP Morgan (Wilson, 2014). Recently, several G8 countries, most notably the United Kingdom and the United States, have been active in creating new social investment models as interest and activity emerge in other countries as well. These initiatives, led by governments, foundations, investors, and other stakeholders, have helped accelerate the market in the past few years (Wilson, 2014, p. 4).

An article published by renowned Harvard Business School professors Michael Porter and Mark Kramer, "The big idea: Creating shared value" (2011), argued that corporate strategies must be adopted to address social needs. Traditional thinking was that pursuing social or environmental objectives could require some financial trade-off, although not necessarily a financial loss. As market experience developed, a growing number of examples demonstrated that, in certain areas, social investments can generate both a solid financial and social return. It is in these areas that Social Investors can play a role in providing private capital to address social challenges in innovative ways (Wilson, 2014, p. 4).

But social finance is still a new concept, and not everybody is familiar with it. Research shows that social finance as an idea tends to be more familiar to people working in the niche financial sectors, such as Socially Responsible Investing and credit unions (Harji, Kjorven, Geobey, & Weisz, 2012, p. 11). This chapter is an attempt to clarify the concept of social finance and its architecture by defining it, explaining how it works, enumerating its types, and examining the benefits of social finance for society and for the future.

What is social finance?

Social finance, despite being a very modern concept, has roots that can be found much earlier. Many elements of what we know as social finance were actually proposed or used by the Islamic financial system or the holy order created by the Poor Fellow Soldiers of Christ and of the Temple of Solomon, founded in the crucible of the Crusades in 1119 (*Policy Review*, 2012, p. 92). Elements of social finance can also be found in some European countries; for example, France, during the 1950s and the early 1970s, invested a lot in social housing. During this time, some of the European economies were influenced mainly by the Keynesian approach, and they used the welfare state model. But after the global economic crisis in 1973, the welfare state model started to shrink and European countries started following neoliberal ideology (*Policy Review*, 2012, p. 92).

Social finance incorporates a number of socially orientated financial activities (Howard, 2012, p. 3):

- Impact Investment—investing for both a financial return and a social return;
- social banking—investing deposits in social enterprises;
- charitable banking—banking with a specific focus on the needs of charities;
- providing banking services and advice to financially excluded individuals;
- crowdfunding platforms for funding social ventures.

There are many definitions of social finance; unfortunately, there is no broadly acceptable definition about "what social finance is and what it incorporates." Such lack of clarity around its

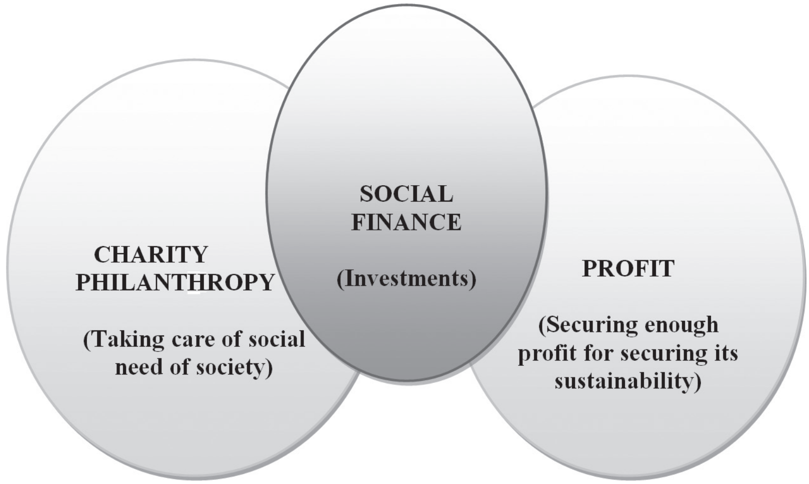

Figure 3.1 The role of social finance

definition and scope influenced the perception of investments in this area as being high risk. The perception is that non-profit organizations rely heavily on grants, which means that these organizations are not interested in managing them toward their growth and profitability (Harji et al., 2012, p. 14).

Social finance is oriented toward investments through which an organization tries to generate financial returns for sustainability by solving social or environmental challenges. Investments are generated from private investors and governments which, through social finance, create profit and bring public good for all. If we analyze the many definitions, we will see that social finance sits between charity/philanthropy and profit. Social finance tries to ensure that an organization is gaining profit so that it can secure its own existence in the future, and while doing so, it is also taking care of social and environmental needs (Figure 3.1). Organizations that are social should not depend on charities. Charities can be an initial resource and they can help in business development, but they should not be an organization's only source of financing (Cetina & Preda, 2013, p. 10).

Social finance is the deliberate, intentional application of tools, instruments, and strategies to enable capital to achieve a social, environmental, and financial return (Harji & Hebb, 2009). Organizations that engage in such investment can be found in the non-profit and for-profit sectors or in the hybrid space between them. Some suggest that social finance pursues a triple bottom-line, to deliver "social, environmental, and economic benefits" (people, planet, profit) (Harji et al., 2012, p. 6). David Hutchison, chief executive of social investment intermediary social finance Ltd., says he defines social finance as "investing capital to create social change" (Howard, 2012, p. 12). Even though there are differences among studies about what social finance represents, we can still find one thing in common: "the innovative use and combination of resources to pursue opportunities to catalyze social change" (Mair & Ganly, 2010, p. 103), which means that the use of social finance will lead to social change, which will in turn lead to a change in social behavior and the social relationship of institutions and people. Social change programs have also been made through social policy and taxation and many other ways in countries like Holland, Norway, Canada, etc. This leads to higher citizen standards and a reduction in inequality in these countries. Howard (2012, p. 3) stated that on a spectrum of investment types, social finance deals with "philanthropy and Socially Responsible Investing" because these organizations do not seek profit maximization, and they distribute their main profit to their employees and investors (usually citizens), and because "Socially Responsible Investing" organizations tend to not maximize their profits, which means when selling cheap but quality products, they usually hire people in need like the homeless, the disabled, and others. Usually they deal with a problem that is for the good of society, and they always take care of the environment.

To deserve the title "social," surely being a little bit social or social at the margins cannot be enough to warrant a totally new asset class. This probably requires a distinction to be made between investors who put capital entirely at risk in a quest to find new solutions to address social needs and those providing low-risk capital at only just below market rates while also achieving some degree of social impact. Social Investors differ from grant funders. "social investment is the provision and use of capital to generate social as well as financial returns." The following are some new and emerging sources of social finance (Strandberg, 2006, p. 5):

1 **Existing pools** of capital, including pension funds, union groups, credit unions, banks, foundations, high-net-worth individuals, investors, Venture Philanthropists, etc.
2 **New pools** of capital, such as foundations or financial intermediaries, develop donation or deposit programs for Social Investors to invest in double bottom-line projects.
3 **Leverage existing capital**, such as using assets within non-profits as loan collateral (e.g., computers, buildings, land, etc.).
4 The Federal **New Deal for Cities** program, which will be transferring tax points to municipalities for use in municipal infrastructure. Can some of this funding be harnessed to support a social economy initiative?
5 **Communities**, which can be a source of capital through credit unions or the community investment model.

In Figure 3.2, we can see an overview of social finance and the way this market operates. There are three sides to this market: the demand side, comprising actors who need social finance; the supply side, where we have the actors who provide social finance; and intermediators, that connect social actors who need additional capital with private actors who can supply capital. Note

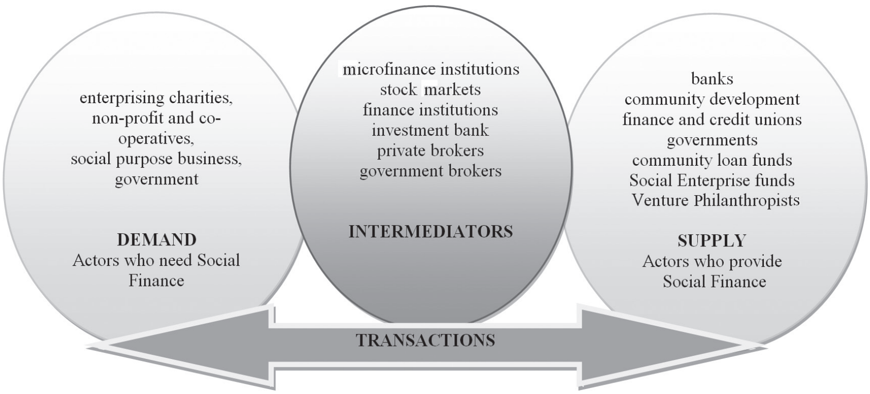

Figure 3.2 Overview of social finance marketplace

Source: Adapted according to Myers and Conte (2013).

that governments can be actors on both the supply and demand sides of the social finance marketplace (Myers & Conte, 2013, p. 9). This model also explains the way social finance works. Intermediators here appear as institutions that help investors invest their money in the demand side for social purposes.

According to the analysis made by Myers and Conte (2013, p. 4), social finance raises a new risk, and they suggest three important caveats that need to be considered:

1 Social finance approaches should not be seen as a substitute for government funding but rather as a complement.
2 Social finance approaches should not be seen as synonymous with privatization of social services. Even though there are differences in defining social finance, it is still generally accepted that social enterprises must have a social mission at the core of their operations.
3 From a more tactical standpoint, social finance approaches are not easy to support. The process of building a social enterprise is similar to starting any kind of enterprise, and having a social mission is no guarantee of success.

One of the questions raised by many actors like governments, organizations, researchers, and other relevant parties is: are there differences between social finance and Corporate Social Responsibility and not-for-profit charity work (Kerlinger & Lee, 1999)? The answer is definitely yes; social finance is conceptually a very different approach to social welfare enhancement. It uses some ideas of neoliberal markets, and it is increasing the need for social and environmental improvements, with a huge potential to make a tremendously positive impact on the economy (Massetti, 2011, p. 61). Another difference of social finance and charities and nonprofit organizations is that social finance secures its own sustainability by being profitable. This means that social finance is not necessarily created by government or through donations but also by using personal funds, borrowing, taking microloans, etc.

Another dilemma is the relationship of microfinance and social finance. Is there a difference? Microfinance is a form of financing that also tries to deal with poverty. The pioneer of microfinance is Muhammad Yunus, who established the Grameen Bank, which from October 2011 gave out microcredit loans (Harji et al., 2012, p. 6). Microfinance got more attention after Yunus was awarded the Nobel Prize in 2006 and also because it was the only asset class that generated a positive financial return during the last financial and economic crisis. According to Yunus (1999), microfinance is the best way to fight world poverty in developing countries. But banks and organizations that practice microfinance, as originally proposed by its creator, are very hard to find, as Yunus stated in a 2015 interview:

> The idea of microcredit has spread across many countries. But there have been certain pain points. People are missing the concept of microcredit. They are using it to make money for themselves, rather than using it as an opportunity to help people to come out of poverty. That is not microcredit.

This is mainly because of existing laws that allow the creation of banks for the rich. You need a banking law to create a bank for the poor, according to Yunus (*Business Today*, 2015). By May 2011, one of the most influential organizations in microfinancing, Kiva, had distributed \$213,942,425 to 554,116 entrepreneurs through 285,142 loans. Surprisingly, the repayment rate has been 98.8 percent (Galak, Small, & Stephen, 2011, p. 130). Even though both methods try to help those who are less fortunate, the difference is that microfinance is a form of crediting and social finance is a form of investment.

Forms of social finance

In literature and practice, there are a few forms of social finance:

1 **Social Impact Bonds (SIBs).** It is important to state upfront that an impact bond is not a "bond" in the sense of a traditional, fixed-rate-and-term security such as a municipal bond but is better understood as a rigorous, outcome-based contract between multiple parties (Shah & Costa, 2013, p. 5). An SIB is an instrument for funding projects where a prearranged amount of money is paid if performance results are achieved. SIBs combine a pay-for-performance element with an investment-based approach: private investors provide upfront capital to fund interventions and can expect to get back their principal investments and a financial return if the results are achieved (*Harnessing the PSF*, 2013). Aligning the interests of non-profit service providers, private investors, and governments, SIBs raise private investment capital to fund prevention and early intervention programs that reduce the need for expensive crisis responses and safety net services. Unlike standard bonds, they are not a form of debt security in which interest is paid by the issuer of the bond to the holder at maturity. In this form, the capital owner is actually sharing the risk with the borrower (the company that gets the capital). The impact bond concept originated in the UK, where the first SIB was launched in 2010. In 2012, it had about £600 million in available capital raised largely from unclaimed assets in British financial institutions (Shah & Costa, 2013, p. 6). New York City established the first SIB in the US. The initiative provides services to 16- to 18-year-olds who are jailed at Rikers Island and aims to reduce recidivism and its related budgetary and social costs. Services have been delivered to approximately 3,000 adolescent men per year from September 2012 to August 2015. Recently, the Harvard Kennedy School SIB Lab requested applications for additional US jurisdictions to assist. Twenty-eight state and local governments applied. Why are so many governments interested in SIBs? SIBs offer an answer to a question all policy makers face in these difficult fiscal times: how do we keep innovating and investing in new solutions when we cannot even afford to pay for everything we are currently

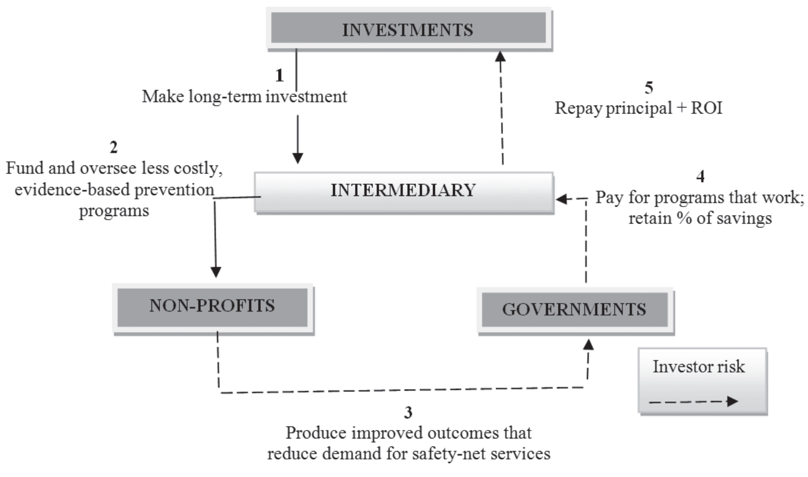

Figure 3.3 The SIB mechanism

Source: Adapted from Liebman, J. B. (2011, February). Social impact bonds. *Center for American Progress*; social finance (2012).

doing? SIBs also align well with the spread of data-driven leadership practices focused on improving government performance and with government efforts too (Azemati et al., 2014). Also, many countries such as Australia, Canada, Colombia, India, Ireland, and Israel have started exploring SIBs. Proposed projects target social problems ranging from recidivism to homelessness, unemployment, youth outcomes, and early childhood education (Azemati et al., 2014). SIBs should not be used in instances where cessation of services would harm a population or to finance critical public services such as primary and secondary education (Shah & Costa, 2013, p. 9).

- An intermediary issues the SIB and raises capital from private investors.
- The intermediary transfers the SIB proceeds to non-profit service providers, who use the funds as working capital to scale evidence-based prevention programs. Throughout the life of the instrument, the intermediary would coordinate all SIB parties, provide operating oversight, direct cash flows, and monitor the investment.
- By providing effective prevention programs, the non-profits improve social outcomes and reduce demand for more expensive safety net services.
- An independent evaluator determines whether the target outcomes have been achieved according to the terms of the government contract. If they have, the government pays the intermediary a percentage of its savings and retains the rest. If outcomes have not been achieved, the government owes nothing.
- If the outcomes have been achieved, investors would be repaid their principal and a rate of return. Returns may be structured on a sliding scale: the better the outcomes, the higher the return (up to an agreed cap).

In Figure 3.3, we can see how SIBs operate in practice. But despite the evolution of the market and the benefits previously mentioned, several challenges remain. These include a lack of products and capital across the full risk/return spectrum, a shortage of intermediaries, and a scarcity of high-quality investment opportunities into which larger amounts of capital can be deployed. Transaction costs in social investment remain high due to fragmented demand and supply and the complexity of deal structuring. As in the mainstream financial markets, there are information asymmetries between investors and investees. These asymmetries are further compounded by the lack of commonly accepted standards for measuring social investment, confusion of terminology, and lack of information about both existing investment provisions as well as related government policy. There is also imperfect competition in the market due to high transaction costs as well as the lack of brokers, advisors, exchanges, and other market mechanisms (Wilson, 2014).

2 **Social Investment Funds (SIFs).** SIFs pool capital from investors to provide loans, mortgages, and venture capital to not-for-profit social enterprises and social purpose businesses with longer payments, allowing organizations to access "patient working capital" (funding with a longer-term repayment schedule) as well as bridge loans. The Social Innovation Fund invites applications from external organizations, sometimes called intermediaries, with strong track records of finding effective social service organizations. Through a competitive process, the Social Innovation Fund grants \$1 to \$10 million per year for up to five years to these intermediary organizations (Shah & Costa, 2013, p. 2). These federal grants then leverage private and philanthropic dollars twice: first, the intermediaries must match the federal grant they receive dollar for dollar with non-federal sources; then, the grantees must likewise match that award one to one with other donations. This funding arrangement means that the \$137.7 million awarded by the Social Innovation Fund since 2010 has leveraged \$350 million in commitments from non-federal sources (Shah & Costa, 2013, p. 3).

3 **Development Impact Bonds (DIBs).** This type of bond takes the SIB model and applies it to another area that has seen a growing emphasis on measurement, evidence, and improved outcomes: international development (Shah & Costa, 2013, p. 10). DIBs are financial instruments that can bridge the gap between investors and opportunities and between financial returns and social benefits. For both SIBs and DIBs, issues around risk and risk-sharing promise to be problematic. DIBs are a new approach, and projects cannot be put together easily using the existing procurement systems of most public sector agencies. Essentially, DIBs are about forming partnerships, and to adopt this new approach, donor agencies should work closely with recipient country governments, potential investors, intermediaries, and service providers. This collaboration will help ensure that DIB contracts are attractive to investors, create the right incentives for service providers, and offer good value to outcome funders, as well as establish a good starting point for future deals. To reduce transaction costs and help build an evidence base for DIBs, pilots should be developed, implemented, and evaluated in a transparent and "open source" way. Donor agencies can drive transparency in DIB transactions by requiring that outcomes data be made public and contracts published. As a results-based approach, DIBs are meant to improve information about the impact of donor funding. This is only possible if information about how funding is being used and the results of the program are publicly known (social finance, 2012). Notably, one of the attractions of the impact bond model for governments is that it transfers away the risk that public dollars will be spent on ineffective programs; however, until the true risks of the model are better known and more predictable, many private investors are likely to balk at the all-or-nothing nature of financial returns inherent to the model (Shah & Costa, 2013, p. 12).

4 **Sector capacity-building organization.** Many submitters suggested creating tools and organizations to help actors within the sector (i.e., Social Entrepreneurs, individual and institutional investors, governments) better understand and engage in social finance. They concentrate on helping Social Entrepreneurs on how to use social finance. They help Social Investors find and evaluate social enterprises in which to invest, etc. (*Harnessing the PSF*, 2013, p. 24). These "capacity builders" seek to lower the transaction costs of social finance by preparing social enterprises for investment, helping Social Investors find appropriate social enterprises in which to invest, simplifying social impact measurement, packaging social investment opportunities for larger investors, and assisting governments with SIB negotiations (*Harnessing the PSF*, 2013).

5 **Pay-for-performance contract.** According to this contract, which is usually an agreement between a government and an external organization where the government sets an acceptable result, if this is achieved, then the government will pay the money. A pay-for-performance contract is one element of an SIB (*Harnessing the PSF*, 2013, p. 23).

6 **Program delivery scaling/leveraging.** A number of submitters to the Call for Concepts recognized the potential of social finance to augment existing programs by providing funds to increase the delivery area, widen the service offering, or add a needed new element to the program (*Harnessing the PSF*, 2013, p. 25). Although these concepts did not all delve deeply into how the financing partnerships might be structured, each provided evidence of the effectiveness of the foundational idea—as in YMCA Canada's concept to create a national, single-window solution to support youth employment through an internship framework. This concept suggests that the multitude of youth employment attachment programs offered across Canada results in a complex and redundant web of resources for youths seeking work, service providers, and employers.

> Accordingly, the YMCA suggests extending its successful national internship program, in partnership with others, to create a one-window network of governments, NFPs, and sector councils to better address the needs of the youth and employers while reducing service duplication. The submission explains: "A national, community based youth internship platform will reduce skills shortages, provide a better matching of youth skills with employer needs, address service gaps for youth, reduce government payroll and overhead costs, and streamline services." A social finance mechanism would leverage investments from multiple sectors and provide matched funding for employer contributions, with success measured through incidence of finding/retaining employment and salary levels. As evidence, the concept notes that more than 75 percent of the 11,000 participants who completed YMCA-delivered, federal government-funded internship programs either found gainful employment, returned to school, or both (*Harnessing the PSF*, 2013).

If we analyze all forms of social finance, we can conclude that the SIB has been the most used and most developed. The main benefit of this form is risk sharing, meaning the organization taking the money will repay it (principal + interest) only if it is a successful project. This is definitely great for the organization receiving the money, but is this the best way to give the money, bearing in mind that the point of social finance is to secure the sustainability of a project? We need to think about whether this money would be spent wisely if the owners knew that if they are not successful they will not have to pay anything. Maybe postponing the payment for some years could be a solution. This problem is also solved by pay-for-performance when organizations will take the money only if they achieved the result set by the government previously. The positive side of social investment funds is that the organization does not need to pay interest and they return the same amount of money, but they need to do this in five years, which sometimes might be very hard for the organization, bearing in mind that they are not for profit maximization, and expecting an ROI in five years is quite a challenge. The main advantage of DIBs is that it uses the money in more effective ways than the government, but the problem here is very similar with SIBs because it enters as a partner in risk sharing. Sector capacity-building organizations help other organizations by teaching them how to use social finance, but there are many issues like how qualified these organizations are, who is going to select them, etc. Program delivery scaling/leveraging opens a window of opportunity for young people by giving them experience.

The importance of social finance in creating social change

Social finance has different organizational intents oriented toward using the power of the marketplace to solve social and environmental problems (Massetti, 2011, p. 50). Prahalad and Hart in 2002 published a paper, "The fortune at the bottom of the pyramid," which discussed the largest but poorest socioeconomic group. According to the research, of the six billion people in the world in 2002, four billion are in the low income group living on less than $2 a day, many of which live on 60–70 cents a day. The percentage of poor people is still very similar. Can this group of people enjoy life like the middle and upper class? In the past three decades, the prices of almost every product have increased a lot. For the fourth tier of people, it will be impossible to ever have the chance to have the same kind of life as the first-tier group. The main problem is that these groups of people are not getting rich at the same speed as the price of almost everything increases, and this means that inequality will be even higher in the future.

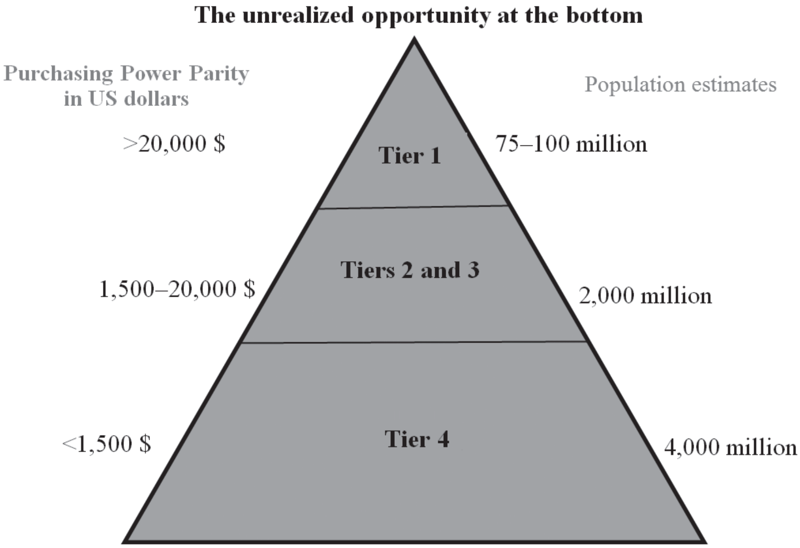

Figure 3.4 Base of the pyramid

Source: Adapted from Prahalad and Hart (2002, p. 4).

Even though every year more than $2 trillion is spent by governments of developed countries, they are still failing to increase the living standards of these people. Go to the website of almost any corporation and you can read about their commitment to the environment, to fighting poverty, to education, to health, or to the arts. None of this is true (Rippey & Subhash, 2013, p. 7). This is mainly because, as Milton Friedman noted in his famous 1962 book *Capitalism and Freedom*,

> [t]here is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition, without deception or fraud.
> *(Friedman, 2009, p. 133)*

Social trends are only getting worse; the number of charities is getting smaller every day, and the number of people in need is increasing especially with an aging population, unfunded pension liabilities, and pressures on the tax system (Strandberg, 2006). The world population has grown rapidly in the last century, moving from 1.6 billion in 1900 to more than 7 billion in 2015 and, according to estimates, will rise to more than 10 billion by 2050. Rapid world population growth results in rapid population aging, which will make it difficult for young people to secure retirement income. In 2011, about 17.66 percent of the Finnish population was aged 65 years or above; because the life expectancy of the Finnish population is around 79.41, it is very hard for the economy to handle figures like this (*Social Landscape*, 2012, p. 51). These and other problems like unemployment, inequality, and the like will require devoting a higher share of society's output to social protection, which needs to be shared in varying degrees between the public and private sector (Asher & Bali, 2014, p. 68).

As Joseph Schumpeter explains, during a period of crises, there will be a rising innovation. This was the case in almost all economic and financial crises (Policy Review, 2012, p. 92). This innovation is social finance and its influence on social innovation and social entrepreneurship; it proposes a better model in solving the problem, especially with the fourth tier, by creating enterprises which will not be motivated to create extra profit but reasonable profit. This means that these corporations will sell cheaper but quality products. Also, social finance will hire employees that belong to different social groups, which will influence their quality of life. The main benefit here will be that it will create an organization that will be sustainable and the government will not need to give such groups charity every year, as these people are employed. Then this money can be spent on other social problems or on creating other social finance institutions to help others. With charity, governments need to sponsor these groups of people every year and do not use their potential. social finance will not be a substitute to the actual system, but it is just offering a solution to some real problems by inspiring social change.

Thus, Ashoka, one of the leading organizations in social finance, is promoting the concept of "full economic citizenship" for civil society organizations and is engaging the corporate sector, particularly financial institutions and policy makers, in developing tools and programs to help civil society organizations meet the challenges of the century (Strandberg, 2006, p. 4). Rather than striving only to externally regulate the institutions of profit maximization, we must move to redesign them at their core (Kelly, 2012). Making the shift, over time, from the dominant extractive designs of today to generative designs, will take a combination of private innovation and government guidance (Kelly, 2012, p. 6). In trying to imagine a large-scale shift in the social architecture of the economy, it may help to recall a prediction made a half century ago by Robert Heilbroner: "Capitalism will inevitably change and in the longer run will gradually give way to a very different kind of social order" (Kelly, 2012, p. 7). social finance approaches help governments improve outcomes by aligning interests so that capital is channeled toward the most effective interventions. The potential of social finance to create incentives for increased alignment may be the most significant benefit that it can bring (Myers & Conte, 2013, p. 6). Kelly (2012) argues that multiplication of these models represents a largely unseen ownership sea change rising across the globe. At its heart is a genuinely different ownership archetype. Instead of being about maximizing financial gains, these ownership designs are about serving the community, often being financially self-sustaining, and many of these institutions are making profits. But they are not profit maximizing. They represent a new category of private ownership for the common good. Taken as a whole, these ownership designs could create the foundation of a new kind of economy, a generative economy, where economic activity again serves its original purpose of meeting human needs. social finance influences the middle class because it creates cheap products and, if the enterprise becomes successful, it will benefit more people.

The relationship of social entrepreneurship, social entrepreneurs, social innovation, and social finance

Social finance actually represents the emergence of new models. These include social enterprises, which serve a primary social mission while functioning as businesses, and these new enterprises concentrate on serving many stakeholders, not just stockholders (Kelly, 2012, p. 3). Social finance then stimulates social innovation, which in turn influences the existence of social entrepreneurship and Social Entrepreneurs. "Social entrepreneurship" emerged in the late 1990s in the United States and the UK, and it has become a global phenomenon, seen as an innovative approach to solve social problems and at the same time create economic value. Social entrepreneurship uses creative talent to develop solutions to social problems ranging from cleaning up the environment to improving conditions for workers around the world; its aim is to use businesses to make money *and* to make the world a better place to live. Social entrepreneurship in practice embraces a wide array of activities, from creative individuals devoted to making a difference to social purpose business ventures dedicated to adding for-profit motivations to the non-profit sector, to new types of philanthropists supporting venture capital-like "investment" portfolios, and to non-profit organizations that are reinventing themselves by drawing on lessons from the business world (Mair, Robinson, & Hockerts, 2006). Jeffrey Robinson defines social entrepreneurship "as a process that includes: the identification of a specific social problem and a specific solution" (Mair et al., 2006). Social entrepreneurship is related to Social Entrepreneurs. According to Francesco Perrini and Clodia Vurro,

> Social Entrepreneurs are change promoters in society; they pioneer innovation within the social sector through the entrepreneurial quality of a breaking idea, their capacity building aptitude, and their ability to concretely demonstrate the quality of the idea and to measure social impacts.
>
> *(Social Entrepreneurship, 2006)*

The origin of the phrase "Social Entrepreneur" can be traced to Bill Drayton, a former business management consultant who in 1980 set up Ashoka, the first foundation to support and fund such individuals. Today, Ashoka has over 2,000 "fellows" in more than 60 countries and continues to expand (Mair & Ganly, 2010, p. 104).

Social Entrepreneurs, then, need to create social innovation which will lead to social enterprise. Social finance is dependent on social innovation and vice versa. Recently, the European Commission published a paper titled "Guide to Social Innovation," which discussed the

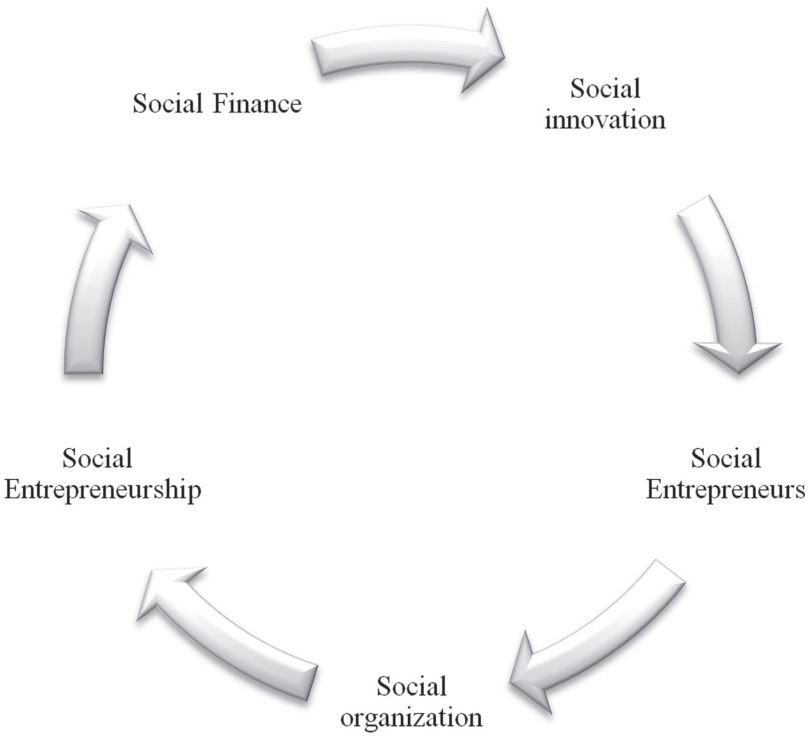

Figure 3.5 The influence of social finance

benefits of innovation and how they can offer social solutions (Myers & Conte, 2013, p. 6). The results of social innovation are all around us: self-help health groups and self-build housing; telephone helplines and telephone fundraising; neighborhood nurseries and neighborhood wardens; Wikipedia and the Open University; complementary medicine, holistic health, and hospices; microcredit and consumer cooperatives; charity shops and the fair trade movement; zero-carbon housing schemes and community wind farms; and restorative justice and community courts. All are new ideas that work to meet pressing unmet needs and improve people's lives (Mulgan, 2010, p. 7). Social innovation refers to new ideas that work in meeting social goals (2010, p. 8).

As we can see in Figure 3.5, social finance is a cycle that influences social innovation, which influences Social Entrepreneurs, which influence the creation of social organizations and, in the end, result in social entrepreneurship. If we analyze Figure 3.5 from the opposite side, we will also understand that social entrepreneurship, social organization, social entrepreneurs, and social innovation influence their existence. This means that social finance influences social innovation but it is also influenced by it.

Role of government in social finance

The role of government in social finance has been critical. One positive example of government engagement we can find is in the UK, where we can find a set of markers around ways in which the government can engage directly or indirectly in social finance (Harji et al., 2012, p. 33). The social finance sector currently struggles to produce desirable returns for investors. High start-up and regulatory costs could prevent mainstream banks from entering the sector (Howard, 2012, p. 6). For social finance to operate, the following public policy changes were identified and proposed (Strandberg, 2006, pp. 7–8):

1. Recast legislation from a for-profit/not-for-profit framework to a sustainable and effective framework.
2. Offer tax incentives to encourage investments in social finance.
3. Create a framework that permits organizations to build capacity through capital retention, for example 25 percent of earned revenues to be allocated to growth and management infrastructure.
4. Create an enabling environment for trustees to consider community investments consistent with their fiduciary duty. Clarify that it is acceptable to maximize returns as opposed to optimizing returns.
5. Create a permissive framework for foundations to support social finance. For example, clarify that foundations can provide loan guarantees and other creative financial instruments to advance the social capital marketplace.
6. Negotiate an allocation from the New Deal for Cities for the articulation of environmental, social, cultural, and economic goals into municipal sustainability plans and checklists.

These are the necessary changes that governments need to make. This is not an easy step, since not all governments have the same potential and current law framework. For some, it would be very challenging; for others, it would be very easy, and some already have this framework. The biggest challenge for underdeveloped and developing countries will be finding the necessary budget and know-how. Considering the whole discussed logic of social finance, it would be better for governments to help their countries concentrate their money on establishing and developing social finance.

Conclusion

Many governments try to deal with poverty by different means, such as social policy, taxation, social work, social welfare, or charity. This way of fighting poverty persists because we just solve problems for the short term. This is not the solution. One of the best solutions to this problem comes from "social finance," which is designed to help economies create situations where everybody will benefit. social finance will help decrease unemployment, it will reduce disparities in the long run, it will better manage poverty, it will encourage taking care of the environment, it will orient our energy toward social innovation, and so on. Social finance has three main postulates: it tries to achieve a social, environmental, and financial return. Social finance is conceptually a very different approach to social welfare enhancement. It uses some concepts of neoliberal markets on the one hand, and it increases the need for social and environmental improvements on the other. It struggles to find a way for people to stand on their own feet, because it helps organizations work profitably. Social finance takes care of enterprise sustainability as these enterprises are self-financed. Social finance is not necessarily created by governments or through donations but by private investors and different organizations using personal funds, borrowing, taking microloans, etc.

Social finance has been a solution to actual economic problems, showing positive effects that were evident in the last financial and economic crises. Should a great economic system show these problems and this very high level of inequality? Social finance does not require a new economic system but uses the actual economic neoliberal system. It tries to solve some of the problems and especially change the logic of Milton Friedman about what social responsibility is. It makes the shift of wealth from the hands of a very small number of rich owners to a huge group of people, who will earn a reasonable profit. Social enterprises are not owned by one person but by many investors giving very small amounts of money or other assets, and usually they are also employed; sometimes these enterprises can be even 100 percent employee-owned. With social finance, many people will be earning a good amount of money instead of just a small group of people getting very rich. Social finance will also lower the prices of products and services, since organizations will not charge huge prices because all of them require reasonable profits. Social finance will address inequality because there will not be extremely rich people who with their great purchasing power can increase the price of goods (e.g., prices of apartments in Manhattan), but these prices will grow very slowly as the living standard of people grows. Many people will be employed, and instances where employees are fired will drop significantly. Social finance also influences social innovation and social entrepreneurship, which can solve many problems of today's economic system. Social finance approaches enable governments to "share the risks" with the private sector. It also helps governments improve outcomes by aligning interests so that capital is channeled toward the most effective interventions. Social finance creates fundamentally different kinds of organizations, helps them stay true to their mission, and encourages different kinds of ownership. This organization will influence the existing architecture and create a different kind of economy in many ways. Social finance actually represents the emergence of new models, and these include social enterprises, which are oriented mainly toward not only solving some social problems but also gaining a reasonable profit. These enterprises are starting to be established all around the globe by many people who really care about social benefits and at the same time want to earn a reasonable profit.

References

Asher, M. G., & Bali, A. S. (2014). Financing social protection in developing Asia: Issues and options. *Journal of Southeast Asian Economies, 31*(1), 68–86.

Azemati, H., Belinsky, M., Gillette, R., Liebman, J., Sellman, A., & Wyse, A. (2014). Social impact bonds: Lessons learned so far. *Community Development Investment Review*, 23–33.

Business Today. (2015, April 12). You need a banking law to create a bank for the poor. *Business Today*, p. 1.
Cetina, K. K., & Preda, A. (Eds.). (2013). *The Oxford handbook of the sociology of finance*. New York: Oxford University Press.
Cho, S., Lee, C., & Park, C. K. (2012, June). Measuring corporate social responsibility: A survey of recent research. *The CPA Journal*, 54–60.
Friedman, M. (2009). *Capitalism and freedom: Fortieth anniversary edition*. Chicago, IL: University of Chicago Press.
Galak, J., Small, D., & Stephen, A. T. (2011). Microfinance decision making: A field study of prosocial lending. *Journal of Marketing Research, 48*, S130–S137.
Harji, K., & Hebb, T. (2009). *The quest for blended value returns: Investor perspectives on social finance in Canada*. Ottawa, ON: Carleton Centre for Community Innovation, Draft Report.
Harji, K., Kjorven, A., Geobey, S., & Weisz, A. (2012). *Redefining returns: social finance awareness and opportunities in the Canadian financial sector*. Toronto, ON: Centre for Social Innovation.
Harnessing the PSF. (2013). *Harnessing the power of social finance: Canadians respond to the national call for concepts for social finance* (Cat. No.: SP-1050-05-13E). Government of Canada.
Howard, E. (2012). *Challenges and opportunities in social finance in the UK*. London, UK: Social Finance.
Kelly, M. (2012, December). The architecture of enterprise: Redesigning ownership for a great transition. *GTI Perspectives on Critical Issues*, pp. 1–7.
Kerlinger, F., & Lee, H. (1999). *Foundations of behavioral research*. Belmont, CA: Wadsworth.
Mair, J., & Ganly, K. (2010). Social entrepreneurs: Innovating towards sustainability. In E. Assadourian (Ed.), *State of the World 2010. Transforming cultures: From consumerism to sustainability* (pp. 103–109). Washington, DC: Worldwatch Institute.
Mair, J., Robinson, J., & Hockerts, K. (Eds.). (2006). *Social entrepreneurship*. New York: Palgrave Macmillan.
Massetti, B. (2011). The duality of social enterprise: A framework for social action. *Review of Business, 33*(1), 50–64.
Mulgan, G. (2010). Measuring social value. *Stanford Social Innovation Review, 8*(3), 38–43.
Myers, K., & Conte, N. (2013). *Can social finance improve the outcomes of employment and training programs?* Ottawa, ON: Social Research and Demonstration Corporation.
O'Donohoe, N., Leijonhufvud, C., Saltuk, Y., Bugg-Levine, A., & Brandenburg, M. (2010). *Impact investments: An emerging asset class*. New York: J.P. Morgan.
Porter, M. E., & Kramer, M. R. (2011). The big idea: Creating shared value. *Harvard Business Review, 89*(1), 2–14.
Policy Review. (2012). The ongoing transformation of social housing finance in France: Towards a self-financing system? *International Journal of Housing Policy, 12*(1), 91–103.
Prahalad, C., & Hart, S. (2002, January 10). The fortune at the bottom of the pyramid. *strategy+business, 26*(1).
Rippey, P., & Subhash, H. (2013). Crossfire: We need to be cautious about accepting CSR funding for economic development initiatives since benefit to disadvantaged producers may not be the ultimate goal. *Enterprise Development and Microfinance, 24*(1). doi:10.3362/1755-1986.2013.002
Shah, S., & Costa, K. (2013, November). *Social finance: A primer. Understanding innovation funds, impact bonds, and impact investing*. Washington, DC: Center for American Progress.
Social Finance. (2012). *A new tool for scaling impact: How social impact bonds can mobilize private capital to advance social good*. New York: Social Finance Inc/Rockefeller Foundation.
Social Landscape. (2012). *PESTLE Country Analysis Report: Finland* (pp. 51–55). London, UK: Market Line.
Strandberg, C. (2006). *Exploring new sources of investment for social transformation* (Social Capital Market Roundtable #2). Vancouver, BC: PLAN Institute for Caring Citizenship.
Tamás, P. A., & Sato, C. (2012). Is the non-unitary subject a plausible and productive way to understand development bureaucrats? *Third World Quarterly, 33*(8), 1511–1525.
Yunus, M. (1999). *Banker to the poor*. New York: PublicAffairs.
Wilson, K. E. (2014, July 1). *New investment approaches for addressing social and economic challenges*. OECD Science, Technology and Industry Policy Papers, France, 15, p. 41.