Social finance: What is social about it

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Abstract

This study examines what constitutes social in social finance. It addresses the lack of understanding of the multifaceted ways in which social finance might be social. The common understanding is that social finance is only social in its use. This study challenges this narrow premise and argues that social finance can be social in its attributes both in its source, uses, infrastructure, policy and design. In other words, social finance can be social in (i) its source, (ii) its uses, (iii) the policy that enables social financing, (iv) the infrastructure used to facilitate social financing, and (iv) the nature or design of the contract that produces the financial instruments used to raise social funds. The implication is that social finance mechanisms can be designed to be social in several ways. Understanding the different ways in which social finance can be social will ensure that we do not dismiss emerging social finance innovations that are not social in their use, but are social in other aspects.

Keywords: social finance, green finance, digital finance, society, financial services, loans

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1. Introduction

This study examines what constitutes 'social' in social finance. Social finance refers to financial flows that are directed to projects and activities that solve social problems and drive positive social change while generating financial returns (Kuchler and Stroebel, 2021). There are many social problems in the world today. Homelessness, unemployment, social exclusion, terrorism, poverty, and racism are examples of the many social problems facing society today. Solving these social problems require funding and this type of funding is loosely termed social finance.

The recent advocacy for social finance arose from the realisation that traditional investors and mainstream financial institutions do not find social investments attractive due its high-risk low financial return prospect (Moore et al, 2012). As a result, many individuals and corporations are beginning to participate in social financing schemes to provide funds and invest in social projects and activities which traditional investors and mainstream financial institutions do not want to invest in. They are finding innovative ways to attract funds and direct financial flows to activities and projects that address a pressing social problem (Andrikopoulos, 2020; Langley, 2020). These efforts are leading to the growth of the social finance industry.

While the growth prospect of the social finance industry is promising, the industry still faces a challenge. The challenge is the narrow understanding of what makes social finance 'social'. The common understanding in the literature is that social finance is only 'social' in its use, meaning that the main determinant of what makes social finance 'social' is in what the funds are used for. In order words, it is social if the mobilised funds are used to address a social need. It is not social if the mobilised funds are used to address a non-social need. This article addresses this issue by highlighting the factors that makes social finance 'social'.

Understanding what makes social finance social is important because it would allow us to understand the various ways in which social finance innovations are social in their attributes and to prevent us from dismissing emerging social finance innovations simply because they are not necessarily social in their use, but are social in other aspects. Consequently, there is a need to increase awareness among individuals, firms, and governments about what constitutes social in social finance.

2. What is social about social finance

This section explains what is social about social finance. It describes the features of social finance that makes it social.

2.1. Social finance can be social in the policy used to enable social financing

Social finance can be social in the policy used to enable social financing if existing policy frameworks and regulations are refined and repurposed to have a social focus. A new policy that prioritizes the development of social finance can also be considered 'social' if it provides incentives for mainstream investors and financial institutions to increase social investment, and if it attracts the public to become socially aware of social finance. A policy that prioritizes the development of social finance can be considered 'social' if has the following elements:

1. Ensure a common understanding of social finance among interested members of the population
2. Promote knowledge sharing on social finance taxonomies in collaboration with financial institutions as this can assist financial institutions in defining social finance, articulating their inclusive social finance strategies, and designing specific social finance products, services, and investment instruments for maximum social impact.
3. Have in-built catalysts that promote social financing within regional, sub-regional, national, and local contexts.
4. Encourage the development of tailored social finance products and services, and also encourage the provision of traditional financial products and services that can be channeled to meet a pressing social need when the need arises.
5. Signal to investors, small businesses, and the general public where they can participate in the social economy by classifying social finance products and services in a taxonomy.
6. Provide access to information on incentivized social finance products and services.

7. Support small businesses that wish to participate in the social economy value chains.
8. Encourage increased collaboration between citizens, the private sector, financial institutions, and the government agencies that are responsible for social finance.
9. Ensure that all stakeholders are aware of new social finance initiatives and opportunities.
10. Minimize risk to social equity and bond investors.

2.2. Social finance can be social in its source

Social finance can be social in its source because certain types of social funds are raised by socially connected individuals or a group of socially connected people. These include funding from a high-net-worth philanthropist, contributions from members of a religious group, donations from a sport group, donations of a community head or wealthy persons in a community, cheap loans from community money lenders for a social purpose, etc (Lehner and Nicholls, 2017). These funds are 'social' in its source because they are raised by a socially connected individual or a group of socially connected people who are part of an extensive social network, and they desire to channel the funds to a common social purpose. These types of funders exist because many mainstream financiers do not want to invest or fund social projects due to the perceived high risks and limited financial rewards of social projects. These challenges present an opportunity for socially connected individuals to use alternative financing methods to raise funds from donations, loans and investments, and handing over the funds to an intermediary e.g., a bank or a mainstream fund manager who will channel the funds to an agreed social purpose determined by the contributors.

2.3. Social finance can be social in the infrastructure used to facilitate social financing

Social finance can be considered 'social' in the type of infrastructure used to facilitate social financing. For instance, we know that social investors are asking for access to information and more transparency on social investments (Hangl, 2014). This should normally translate to the provision of more information to social investors. The need for more information can be addressed by establishing an information infrastructure, such as a reputable website, where social investors can access all the information they need about social finance and investments. The public sector and private sector can collaborate and establish a firm whose role is to develop and manage a reputable social finance website that provides social investors, social bond issuers, and the general public with information about the full list of existing social equity investments, social bond investments, social finance news updates, a list of the leading firms and financial institutions involved in social financing, interesting articles about social financing by social finance thought leaders, and all other types of social finance information. The aggregation of social finance information in one website gives extra visibility and credibility to the emerging social finance industry, and it gives investors some confidence that the information posted on the website has been internally screened and externally vetted for correctness and accuracy. Another idea is the development of a social (bond & stock) exchange infrastructure which can serve as a place where all social bond and equity investors go to invest (Dadush, 2015; Wendt, 2021). The social bond & stock exchange will offer social bond and equity investment opportunities into firms that drive positive social progress, thereby facilitating social investment and contributing to improving the wellbeing of all members of society.

2.4. Social finance can be social in the nature or design of the contract that produces the instruments used to raise social funds

Indeed, social finance can be social in the nature or design of the contract that produces the financial instruments used to raise social funds. Consider the case of social impact bonds, for example. Social impact bonds are contractual financial instruments which are designed to allow an investor to provide funding for a social intervention (Andrikopoulos, 2020). The funding provided by the investor is available as working capital for a service provider that is responsible for delivering a specified social service. Once the social outcome has been achieved, the investor is repaid the principal and a rate of return, and the service provider is also paid a fee (Mulgan et al, 2011; Rizzello and Carè, 2016). Social impact bonds are considered 'social' because the underlying contract is designed to be a pay-for-performance arrangement that is intended to yield a clearly defined social outcome. Another example is a social equity investment or social equity fund. This is type of fund is a contractual agreement in which an investor provides finance in the form of equity to an organisation involved in social work in return for total or partial ownership of the organisation and with the expectation of receiving a share of the organisation's profits (Brown, 2006). The social equity fund is considered 'social' because the underlying contract is designed to allow an equity investor to provide funds to advance the social work carried out by an organization while the investor gains some ownership control and a share of the profit generated from undertaking the social work.

2.5. Social finance can be social in its use

Social finance can be 'social' in its use if the funds being raised are actually channeled to projects and activities that drive positive social progress and to projects and activities that address the world's most difficult issues such as climate change, poverty, hunger and loss of livelihoods. The fund has to be used to solve a pressing social need or a pressing environmental need for it to be considered 'social' in its use (Kuchler and Stroebel, 2021; Ozili, 2021). If this does not happen, the funding cannot be considered to be 'social' in its actual use. This is an important distinction because it helps to easily mitigate social-washing. Social-washing is a term used in social finance to describe a situation where an individual or a firm makes unsubstantiated claim or false impression that it will use the generated social funds to meet a pressing social or environmental need but fails to use the funds to meet any identifiable pressing social or environmental need. The aim of social-washing is to deceive members of society and the authorities into believing that an individual or a firm is socially friendly or have a greater positive social impact than they actually do. To mitigate social-washing, there is a need to ensure that all social funds are used to meet a clear, identifiable and commonly agreed pressing social or environmental need.

3. Conclusion

Social finance innovations are growing rapidly. It is a way of meeting social needs while generating financial returns. Social finance refers to all financial mechanisms and investments aimed at addressing pressing social problems. This article addressed the narrow understanding of what makes social finance "social". The article showed that social finance can be social in its attributes both in its source, uses, infrastructure, policy and design. In other words, social finance can be social in (i) its source, (ii) its uses, (iii) the policy that enables social financing, (iv) the infrastructure used to facilitate social financing, and (iv) the nature or design of the contract that produces the instruments used to raise social funds. The implication of the findings is that social finance mechanisms can designed to be social in several ways. Understanding the different ways in which social finance can be social will ensure that we do not dismiss emerging social finance innovations that are not social in their use, but are social in other aspects.

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