

Private Sector & Development

PROPARCO'S MAGAZINE

SOCIAL BUSINESS: A DIFFERENT WAY OF DOING BUSINESS AND INVESTING

COMBINING SOCIAL PURPOSE AND ECONOMIC
EFFICIENCY IS THE RATIONALE BEHIND SOCIAL BUSINESS.
HOW CAN THE TREND BE CONSOLIDATED AND ENHANCED?

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BÉNÉDICTE FAIVRE-TAVIGNOT →

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BÉNÉDICTE FAIVRE-TAVIGNOT

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EDITORIAL

In recent years, the concept of social business has emerged as a middle road between philanthropy and the pursuit of maximum profit. The idea is rooted in a dual realization: on the one hand, governments and civil society are striving – especially in poor countries – to resolve problems such as food insecurity and insufficient access to healthcare, water, energy and adequate housing. On the other, the principle of maximizing profits is showing its limitations by intensifying pressure on resources, contributing to global warming and widening social inequality.

The private sector can provide solutions to these challenges: through social business, it supports social causes. Profit thus becomes the means rather than the end; businesses are not acting independently but in co-creation with public institutions and civil society. This approach is attracting many actors: employees seeking meaning in their work, politicians aiming to reduce unemployment, companies keen to win public trust and, in some cases, play a true role in society, responsible investors, international donors, etc.

But where does the boundary lie between “social business” and “business as usual”, especially where return on investment is expected? How can we tell the difference between sincere, proactive commitment and a mere attempt to jump on the “social” bandwagon? And, intentions aside, how can we evaluate the net impact of social business? Furthermore, impact investors have very diverse expectations in terms of financial and social returns. How can these best be met? All these questions cry out for clear definitions linked to explicit indicators and accurate classification of returns on capital.

“In recent years, the concept of social business has emerged as a middle road between philanthropy and the pursuit of maximum profit.”

But is this twin pursuit of social and economic objectives not over-idealistic? Very few social businesses achieve breakeven results, for example. How can we find the right economic model to meet the needs of poor communities while generating a profit? And once the model is established, how can we change the scale?

This twenty-third edition of *Private Sector & Development* addresses many of these questions and attempts to define the conditions for sustained and large-scale social business development. The prize is worth fighting for. The goal is to pave the way for a truly inclusive economy based on co-creation between different partners, giving everyone access to essential goods and services, decent work and a fair share of the value. This is the fundamental challenge that drives social business. ■

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David Auerbach co-founded Sanergy, a pioneering social business that provides affordable, safe sanitation to residents of urban informal settlements in Africa. He served as Deputy Chair for Poverty Alleviation at the Clinton Global Initiative. David began his career researching foreign policy at the Center for American Progress before teaching in central China for two years. He holds numerous fellowships as well as an MBA from the MIT and a BA from Yale University.



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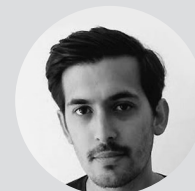
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Since 2012, Jean-Gabriel Dayre has been a Senior Investment Officer in the Proparco Banking division where he is head of the microfinance sector. He actively contributed to developing the Social Business strategy of the AFD Group, where he also worked on risk sharing mechanisms and SME finance. Prior to that, Jean-Gabriel was a financial analyst at Citigroup in London. He is a graduate of ESPC Europe and Sciences Po Paris.



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As project leader at CEFEB, Jeanne Hénin develops "Social Business" and CSR capacity-building programmes. Before joining CEFEB, she worked at Proparco where she introduced an impact measurement process for evaluating development projects. She played an active role in building the AFD Group's Social Business strategy. Since graduating from the EDHEC Business School, Jeanne has also worked as a consultant at Ernst & Young and as a project leader in a Cambodian NGO.



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THE AMBITIONS AND CHALLENGES OF SOCIAL BUSINESS

BETTER DEFINING AND STRUCTURING THE SECTOR

Social business is a demanding business model: social enterprises pursue social or environmental goals while also seeking long-term profitability and they face many challenges. In the wide-ranging 'impact investing' sector, it is vital that the social businesses are able to structure and differentiate themselves, both to attract investment and to boost their impact.



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Despite the involvement of the international community and extensive multi-actor engagement, guaranteed access to essential goods and services is still a long way off for the world's poorest populations. 1.5 billion people do not have reliable access to clean, affordable electricity; more than a billion lack drinking water or adequate health facilities; access to existing treatments for infectious diseases such as HIV/AIDS, tuberculosis and malaria is still very limited; and 70% of all children around the world not attending school live in Southern Asia and sub-Saharan

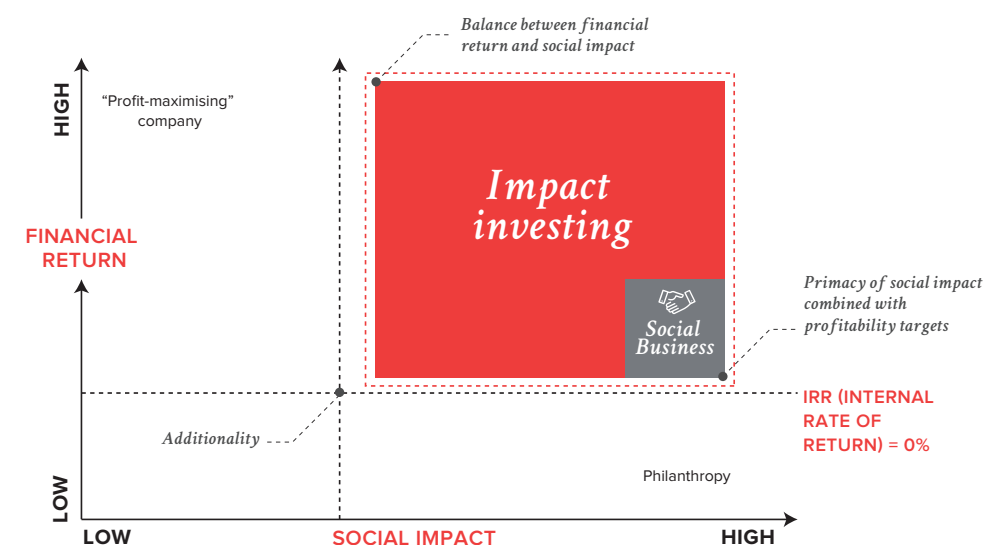
Africa (Acumen, Hystra, WHO, 2014). Public funding alone cannot tackle all these challenges and while the private sector is already a significant funding source of development,¹ there is a need for new sources to be harnessed so that wider approaches can be developed, 'workable' solutions disseminated, and innovative responses devised that will benefit the very poorest. Working alongside the public sector, which plays a vital role in all these areas, investors and social enterprises face the challenge of developing capacity to meet this global demand for goods and services at affordable prices.

THE EMERGENCE OF 'SOCIAL BUSINESS': THE CULMINATION OF A LONG STORY

The business world has many different terms for enterprise with a social or environmental focus, including "the social and solidarity economy", "social

entrepreneurship", "bottom-of-the-pyramid initiatives", "the inclusive economy", "impact investing" and "social business". However, while these terms appear to refer to the same concepts, they need to be differentiated. "The social eco-

➔ Social businesses, a niche of impact investing



Source : Proparco

nomy" is an established term that represents a global attempt to combine economic activity and social benefits. This movement has produced different kinds of business, including cooperatives and mutual societies. Since the late 1990s, traditional private sector businesses have increasingly been embracing environmental and social issues, initially by focusing on controlling their environmental and social risks, and subsequently by incorporating notions of sustainable development and corporate social responsibility (CSR) into their organisation. At the same time, the financial sector has been creating "socially responsible investing" (SRI) tools – new investment vehicles that enable investors to monitor how their assets perform in social and environmental terms. Clearly however, some CSR practices and SRI-labelled products are designed more to 'do no harm' than to actually solve current societal problems. More generally, the "social economy" has not

grown as expected and remains marginal in economic terms. This has given rise to the concept of "impact investing". This term was coined in 2007 and, according to the Global Impact Investing Network (GIIN), it means "investments made into companies, organisations, and funds with the intention to generate social and environmental impact alongside a financial return." A wide range of stakeholders, representing cultures and objectives as diverse as pension funds and NGOs, use this term. It is also used both by those seeking to serve vulnerable populations and pursue primarily social goals ("impact first" stakeholders), and by financiers from the traditional private sector, whose main aim is to access new markets ("financial first" stakeholders). In this model, "social business" is a sub-set or niche of the wider and more diverse concept of "impact investing" (FIGURE ➔), although its definition remains relatively vague. ➔

¹ According to an OECD report (OECD, 2014), global Official Development Assistance (ODA) totalled USD 134.5 billion in 2013, but direct foreign investment in developing countries in the same year was USD 758.2 billion.

SEGMENTING THE IMPACT INVESTING SECTOR TO DISTINGUISH
DIFFERENT LEVELS OF SOCIAL AND FINANCIAL REQUIREMENTS

Tackling the challenge of access to essential goods and services relies on large-scale mobilisation of funding. The recent development of impact investing therefore represents a genuine opportunity – providing that such investment is structured and avoids the trap of ‘social washing.’ This is important because any mismatch between investors’ expectations and companies’ actual social and financial performance is likely to create mistrust among investors. It is therefore essential to clarify and distinguish between stakeholders’ differing levels of social and financial expectations of the projects in which they intend to invest. Those in the financial sector expecting such investments to be highly profitable must be able to easily select “financial first” projects; by contrast, those prioritising social returns must be able to channel their investment into “impact first” projects. The fact that it is difficult to identify these different types of projects and investments is currently hampering growth in the sector. And in the absence of any authoritative standardised classification,² the minimum that is needed is a set of selection criteria that enables investors to distinguish between projects.

There is a consensus around a few aspects of what constitutes a social business. Social businesses formally pursue social or environmental goals above all others and operate according to a long-term economic model that does not rely on subsidies. Social enterprises take on both private sector forms (as companies, cooperatives or social investment funds) and voluntary sector forms (as NGOs or foundations). There are also ‘secondary’ criteria, which include their governance arrangements, how they allocate their profits, their legal status, the importance they attach to innovation, and whether their economic model is transferable and has the potential to operate on a wider scale.

The Agence Française de Développement (AFD) Group has sought to qualify the most demanding business model – “impact first” business – as “social business” by identifying three defining criteria. The first two broadly mirror the definitions in common use, however the third arises directly out of Pro-parco’s experience as an investor. This criterion reflects the coherence that should exist between the organisation’s economic activity, governance, practices and social/environmental aims (FIGURE ➊): for example, a company’s mission should be formally written into its Articles; it may set up a committee that reports to the Board of Directors to monitor social performance; and remuneration should be geared to impact goals. The issue of definition is crucial as it enables the differing levels of financial and social goals represented by sector stakeholders to be identified. Moreover, greater clarity in this area will enable investors to identify projects that best meet their own needs. Defining, categorising and structuring can only benefit investment. Issues of definition also underline the ongoing conflicts in the sector between social goals and profitability.

“Any mismatch between investors’ expectations and companies’ actual social and financial performance is likely to create mistrust among investors.”

² • B-Analytics’ – GIIRS Rating scheme for investment funds – and the Social Business Scorecard (SBS) in the social business area, set up by the CERISE platform, are the two most successful initiatives so far.

THE SPECIFIC CHALLENGES FACING SOCIAL BUSINESS: MAINTAINING A
BALANCE BETWEEN SOCIAL GOALS AND LONG-TERM FINANCIAL PERFORMANCE

By their very nature, social enterprises face a conflict between financial performance and social performance. Although there may be a virtuous circle in which these goals are actually the same – for example, where the enterprise can make itself more efficient by pursuing social goals and deploying good CSR practices, especially with regard to respect for both customers and employees – trade-offs are often required between these goals, particularly in the case of young businesses that are still seeking to establish long-term economic viability.

These conflicts reflect those in the sector itself, where there is a very real risk of making over-ambitious promises to investors. It is not credible to promise both a big social impact and a substantial financial return – and to do so is also very risky. The enterprise risks sacrificing the social mission it originally embraced in favour of profitability – and suffering “mission drift” – or restricting its target group from the outset to what is achievable, i.e., a less demanding group in terms of its demographic make-up (poor populations as opposed to middle-class ones) or its geographical profile (urban versus rural areas). If a social enterprise is to maintain its credibility and its specificity, it must not dilute the social and environmental objectives of the projects it undertakes.

“It is not credible to promise both a big social impact and a substantial financial return – and to do so is also very risky.”

There may also be conflicts between differing social goals, such as quality and accessibility of service. Provision of a quality service is linked to the goal of providing that service to the greatest number of people at an affordable price. To meet both of these aspirations, social business models make use of traditional cost-reduction levers – economies of scale, service standardisation, etc. – or rely on technological and organisational innovation to enable them to optimise the cost of their service without compromising on quality. ➔

➔ AFD group criterias for social business

Social Business		
Criterion 1 Primary social and/or environmental goal	Criterion 2 Search for economic sustainability	Criterion 3 Organisation reflecting social goals
Social goal and/or Environmental goal	Economically viable model aimed at achieving financial autonomy without any reliance on subsidies	Governance tailored to goals
Formally documented goal that constitutes the business’s <i>raison d’être</i>		CSR practices
		Measurement of results and impacts
		Financial aspirations tailored to goals

Source: AFD

“Social business currently remains a sectoral niche (...) However, that should not downplay the benefits the sector offers, including its ability to serve as a laboratory for social innovation.”

There is no shortage of measurement and evaluation methods and tools (sets of indicators³, standardised externalised tools⁴, ‘robust’ impact studies, etc.), and in the face of such complexity, there is a strong temptation to adopt a “one-size-fits-all” standard. However, it would be both reductive and risky to go down that road: any individual method may be appropriate at a given point in the life of a project, however the sheer range of sectors, social goals and corporate models often requires specific indicators. Moreover, if a measurement system is to help track social performance, it must be fully integrated within – and tailored to – the enterprise’s working methods. The sector’s complexity cannot be “boiled down” to a single standard although it would be useful if public institutions were to encourage guiding principles that could be applied to social business. Having a shared vocabulary would enable impact to be compared, social performance to be gauged appropriately and the sector to be segmented accordingly.

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Resources for Sustainable
Development.

3 • IRIS is a platform bringing together a range of sectoral indicators for measuring the financial, social and environmental impact of companies in the impact investing sector (<https://iris.thegiin.org/about-iris>).

4 • B-Lab offers standardised methods for measuring the impact of projects carried out by companies with a social mission (<http://blimpactassessment.net/about-b-impact>).

It is still unclear how extensive the market is for social business enterprises and social investment funds. The value of global investment in the broad area of impact investing is open to debate, with estimates heavily dependent on definitions. The most recent assessment by GIIN puts investment in 2012 at USD 8 billion, with a total of USD 9 billion estimated for 2013. Adopting a narrower or more rigorous definition of “social business” suggests that the sector is growing but puts its current value in hundreds of millions – rather than in billions – of dollars. However, there are major regional differences: social business in India and some African countries (particularly Kenya) has already reached a certain level of maturity. Ultimately, social business currently remains a sectoral niche, and only a relatively small number of social enterprises have genuinely been able to scale up their operations. However, that should not downplay the benefits the sector offers, including its ability to serve as a laboratory for social innovation.

Development banks and social funding institutions have a vital role to play in structuring the sector. With their vast experience in the microfinance and climate financing sectors, these institutions are well placed to support the sector as it grows and they could position themselves in a range of areas: financing innovation in risk-sharing ventures (risk capital) and long-term investment; developing the social business ecosystem by creating market infrastructure (‘incubators’, forums, information platforms, and professional associations and networks); helping to establish new social enterprises with proven business models; and helping to promote the introduction of rigorous methods for measuring impact. ■

A FEW LESSONS FROM THE DFID IMPACT FUND EXPERIENCE

While poor people in developing countries are more than willing to pay for basic goods and services, the existing private sector solutions in place so far do not allow them to meet such needs effectively. They often have to pay higher prices for similar goods and services, or settle for inferior quality.¹ We believe that development finance institutions have an important role to play in boosting private initiatives as social and profitable businesses. DFID decided to enter the impact investment market to tackle some of the significant challenges it faces (including market fragmentation, information mismatch and limited fund manager ability to measure the social and environmental performance of impact investments). It is in this way that the DFID Impact Programme was created in 2012. As a key part of this Programme, the USD75m DFID Impact fund was established to invest in businesses that generate benefits for the poor while also achieving profitability. This facility, which is managed by CDC, the UK’s development finance institution, uses a ‘fund-of-fund’ approach – CDC selects and partners fund managers. The USD40m DFID Impact Accelerator Facility, also managed by CDC, invests directly in transformative enterprises. In the short term, these funds will use the capital raised to boost co-investor confidence through robust due diligence of investees’ financial returns and development impact, and by offering limited potential subordination to private investors where necessary to catalyse their participation. In the longer term, they aim to raise additional capital by demonstrating the financial viability and positive impact of pro-poor business models.

With a mere three years of operational experience, the funds are already supporting a large

number of pro-poor businesses. Importantly, several of these businesses are showing signs of profitability despite still being in early stages of their lifecycle. Here are a few key early lessons we have learnt:

- For social businesses to achieve any impact they need to be financially sustainable. This may take longer than for a typical commercial enterprise but both types of businesses ultimately need to achieve this in order to have a long-term impact on livelihoods.
- Most businesses need to serve customers across different income levels in order to be sustainable and companies that rely solely on low-income consumers or suppliers often struggle, especially in the early stages. Moreover, most fund proposals that we have received in traditional developmental sectors (e.g., health and education) have deployed business models with a cross-population focus.
- We believe grant capital can play a meaningful role in the early-stages in helping certain social businesses to achieve the scale needed to attract investment capital.
- Because poverty reduction is an ambitious and very complex goal we need to develop clarity in measuring success. As impact investors, we are very cautious when claiming any impact on poverty reduction. Consequently, we now measure our impacts on the livelihoods² of the poor, which we would argue is a more realistic aim. We measure outcomes by first looking at what companies measure (e.g., customer satisfaction, product quality, etc.), and then based on existing available research (e.g., impact evaluation of relevant services, data on specific aspects of poverty in local markets) and a programme of “deep dive” studies (still in the design phase). ■



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FOCUS DFID/CDC

The Department for International Development (DfID) is a United Kingdom (UK) ministerial department responsible for administering overseas aid. CDC is the UK development finance institution, wholly owned by the Government, dedicated to private sector financing.

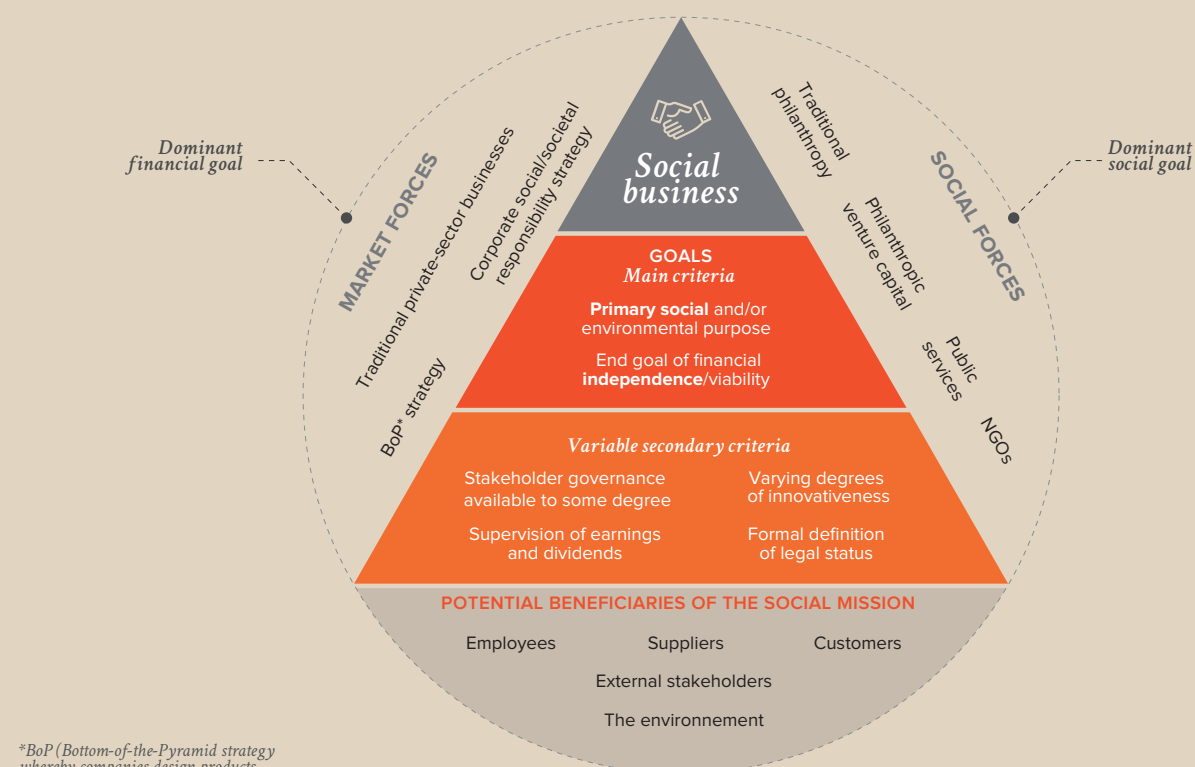
1 • For example, the slum-dwellers of Jakarta, Manila and Nairobi pay 5-10 times more for water than higher-income consumers and – incredibly – more than the residents of London or New York (UNDP, 2008).

2 • Benefits to livelihoods can include impacts on incomes and productivity, health outcomes, education, energy.

WHAT IS MEANT BY SOCIAL BUSINESS?

Prepared by Clélie Nallet, Deputy Editor

Social businesses have attracted an enthusiastic following in economic, political and media circles. A wide range of actors describe themselves as such, even though there is no consensus as to a definition. The term's close connection to other concepts, such as inclusive business, the social economy, impact investing and Bottom-of-the-Pyramid (BoP) initiatives, only fuels this nebulosity. Since its definition is subject to debate, the social business phenomenon is difficult to quantify. This partly explains the scarcity of statistical data on the subject. However, there are some studies which shed light on the sector's dynamics such as monographs conducted in India and Madagascar or impact investing and BoP reports, which reveal some of the market's major trends.



*BoP (Bottom-of-the-Pyramid strategy whereby companies design products that can be sold to the poorest consumers)
Source: AFD, 2015

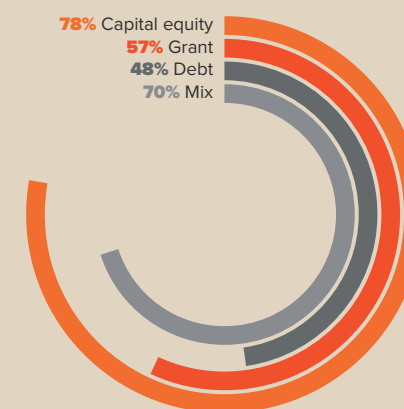
» Currently, there is no standard definition of social business. Nevertheless, the various approaches all seem to share two fundamental principles: a key social purpose and the need for financial independence, while generally differing on four, more secondary criteria. Social business is at the interface between commercial enterprise, market needs, social goals and public services. It can operate in a wide variety of sectors (for instance, financial inclusion, nutrition, food safety, healthcare, education, housing, water and sanitation, and

energy). Direct beneficiaries of the social mission include consumers (poor people given access to essential goods or services at low cost), employees (disadvantaged people given jobs), suppliers (guaranteed steady income and given assistance with sector structuring), the environment (mitigation, adaptation and protection) and external stakeholders (NGOs, local communities, etc.).

Source: AFD, 2015 (extracts)

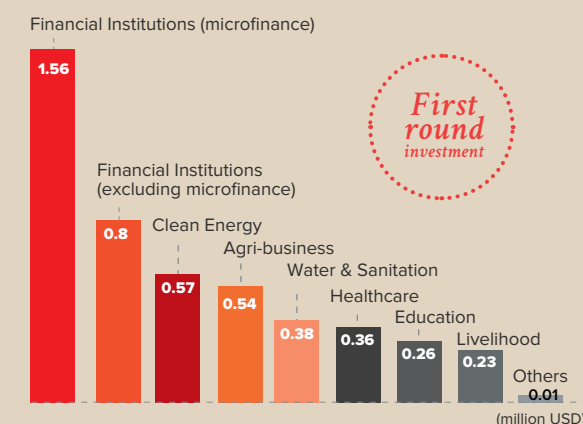
ON THE SOCIAL BUSINESS SIDE

Social businesses' financing needs ▼



Source: Intelicap, 2012 / Methodology: data were collected from 95 social businesses in a range of sectors throughout India. Because of the size and maturity of India's social businesses, the country is a good indicator of key trends across the sector as a whole.

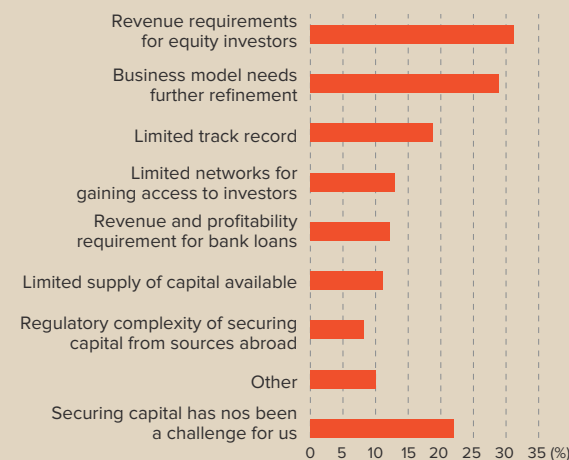
Average investment in social businesses ▼



Source: Intelicap, 2014 / Methodology: data were collected from 65 impact funds in India. Because of its size and maturity, the Indian social business sector is a good indicator of key trends as a whole.

» Most social businesses are the size of an SME and typically require under USD 2 million in financing. They most often require a combination of financing instruments. Grants are usually essential during the start-up phase.

Social businesses' main constraints to financing ▼



Source: Intelicap, 2012

Social businesses' main challenges to development ▼



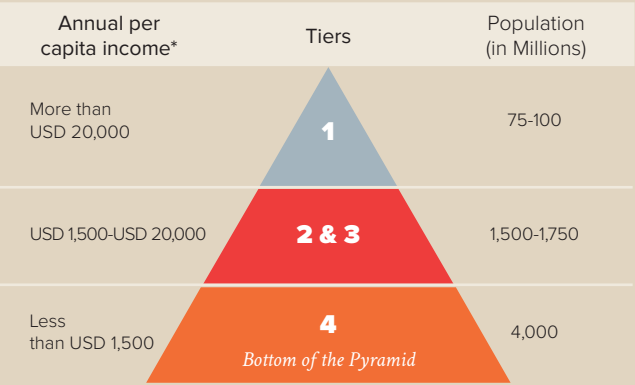
Source: Intelicap, 2012

» The Intelicap study, which surveyed 95 social businesses in India, revealed the main difficulties related to seeking financing and scaling up. The two main challenges facing these businesses appear to be raising capital (structure and term not suited to market requirements) and hiring/retaining qualified staff.

KEY DATA

FIGURES

The world economic pyramid ▼



* Based on purchasing power parity in USD
Source: Prahalad, C.K., Hart, S.T., 2002

» The Bottom-of-the-Pyramid concept was popularised by the work of C.K. Prahalad and Stuart L. Hall at the end of the 1990s. They argued that by targeting populations at the bottom of the pyramid (BoP), businesses could significantly reduce poverty at the same time as benefiting from substantial business opportunities. And indeed, the size of the BoP market is actually offsetting the weak purchasing power of individuals while considerably raising overall purchasing power. According to 2010 estimates (Drayton, B., Valeria Budinich, V., 2010), the BoP market – the main target of social business – is believed to be worth USD 6 trillion. That said, such estimates depend on the criteria used to define the BoP, which can vary widely depending on the study.

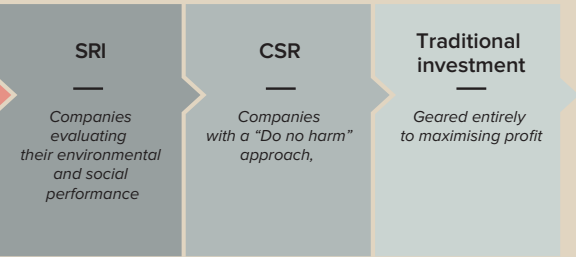
The investment philosophy spectrum ▼

Geared entirely to social goals



Source: Dayre, J.G., 2016

Geared entirely to financial goals



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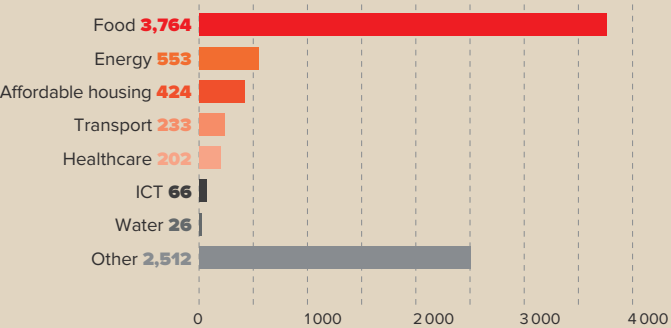
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Breakdown of BoP expenditure, 2010 ▼

in millions of PPP USD

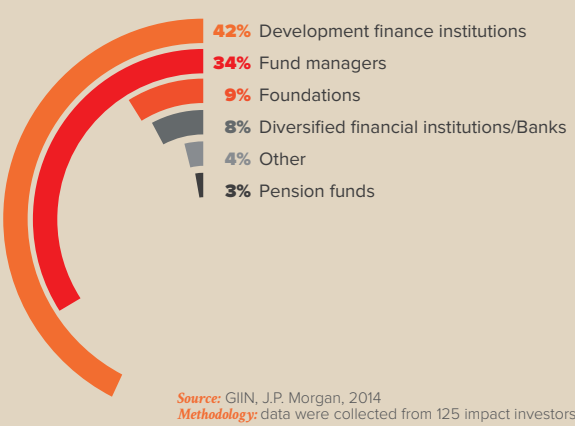


Source: Drayton, B., Valeria Budinich, V., 2010

ON THE FINANCER SIDE

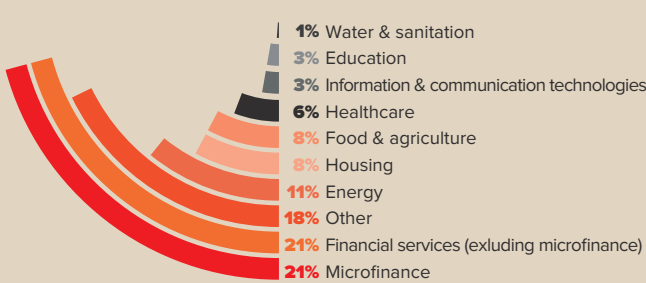
Who engages in impact investing? ▼

Assets under management by investor type



» A wide range of organisations are involved in impact investing, from socially responsible investment funds to foundations, and from NGOs to large companies. The bulk of their funding goes to mature enterprises that are in the early or growth stage. In addition, many impact investors target below-market financial returns or simply a return of capital.

Impact investments by sector ▼

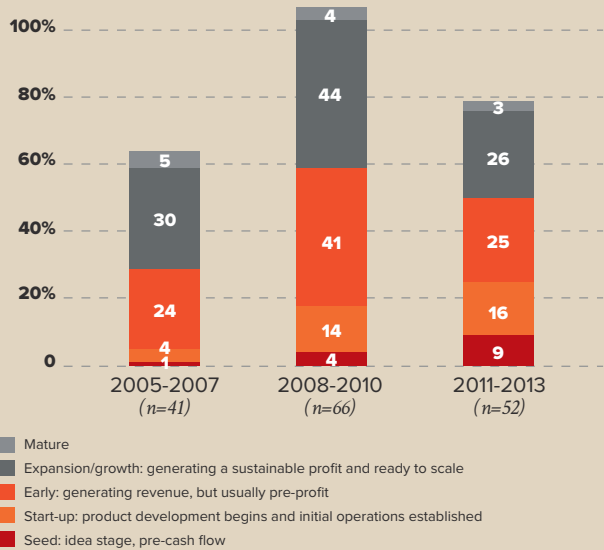


Source: GIIN, J.P. Morgan, 2014
Methodology: data were collected from 125 impact investors.

» While the recipients of impact investing span a variety of sectors, inclusive financial service providers and microfinance institutions with tried-and-tested business models still constitute a large majority.

Maturity level of investees ▼

Number of investment vehicles by business maturity stage



Source: ANDE, 2014
Methodology: the study was conducted among members of the Aspen Network of Development Entrepreneurs and other impact investors selected according to the emerging markets targeted with transactions ranging from USD 20,000 to USD 2 million and business sector variety. Each investment vehicle could select more than one stage.

Challenges to the growth of impact investing ▼

Rank	Score	Available answer choices
1	165	Shortage of high quality investment opportunities with track record
2	161	Lack of appropriate capital across the risk/return spectrum
3	98	Difficulties with exiting investments
4	82	Lack of innovative deal/fund structures to accommodate investors’ or portfolio companies’ needs
5	80	Lack of common way to talk about impact investing
6	73	Lack of research and data on products and performance
7	49	Lack of investment professionals with relevant skill sets
8	42	Inadequate impact measurement practice

Source: GIIN, 2014
Methodology: data were collected from 125 impact investors.

THE DIVERSITY OF SOCIAL BUSINESS: THE CASE OF MADAGASCAR

Prepared by Nicolas Vincent, Research Officer, AFD

Despite a troubled macroeconomic and political environment, Madagascar possesses a fairly diversified, dynamic economic fabric in comparison to other countries with a similar level of development. This national particularity undoubtedly explains the country's thriving social business sector. A study undertaken by AFD¹ lists close to 90 projects² that meet the broad definition of a social business, i.e., organisations (of all types) whose priority is to address a social problem and who aim to be financially self-sustainable³.

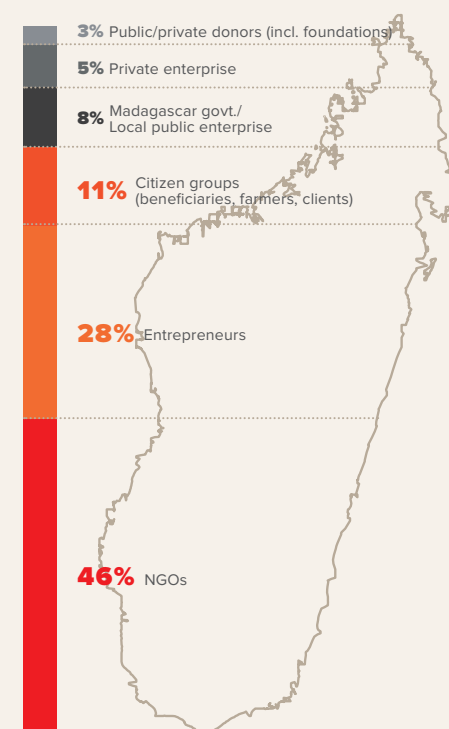
WHAT IS THE KEY DRIVER OF SOCIAL BUSINESS IN MADAGASCAR? ▼

In a country with over two thirds of the population living in poverty and with little in the way of essential government services (due to serial political crises), non-state actors attempt to come up with alternatives in the hope of offering the population better living conditions.

“The projects covered are on average 10 years old and over a third have existed for more than 15 years.”

We are referring here to organisations that are part of civil society – not only NGOs, but social business projects as well, which have a long history in Madagascar. Many of these existed before Muhammad Yunus coined the term “social business”. The projects covered are on average 10 years old and over a third have existed for more than 15 years. Nearly half of all such projects (46%) were initiated by NGOs that wished to generate their own revenue to finance their development rather than being entirely dependent on public funding.

Project initiators ▼

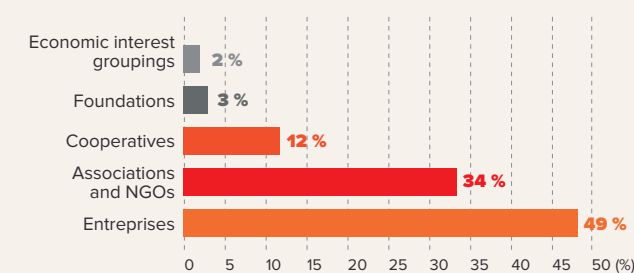


Source: AFD, 2015

WHAT ARE THE KEY FEATURES OF SOCIAL BUSINESS PROJECTS IN MADAGASCAR? ▼

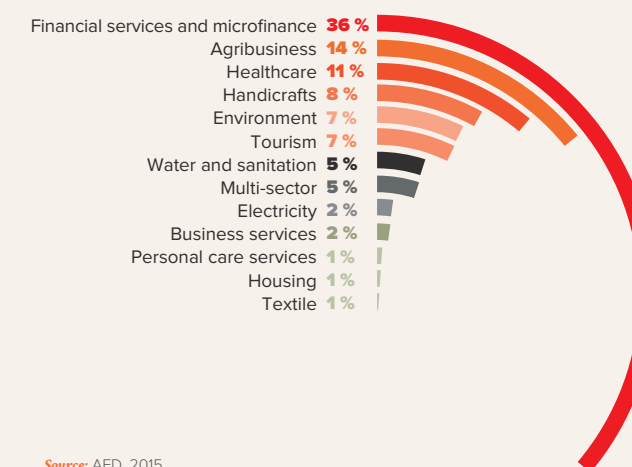
A particularly striking feature of the social business projects in the study is their diversity – in terms of the social problems addressed (i.e., job opportunities, making essential products and services accessible to the poorest, assistance in organising production chains, environmental protection, etc.), the sectors involved (although microfinance still funds nearly one-third of all projects), the initiators' legal status (companies, associations, NGOs, cooperatives and in some cases hybrid approaches) and their targets (customers, employees, suppliers and other stakeholders, the environment). This highlights the cross-cutting nature of social business and the opportunities for adapting its business model to a wide variety of settings. →

Diverse legal status ▼



Source: AFD, 2015

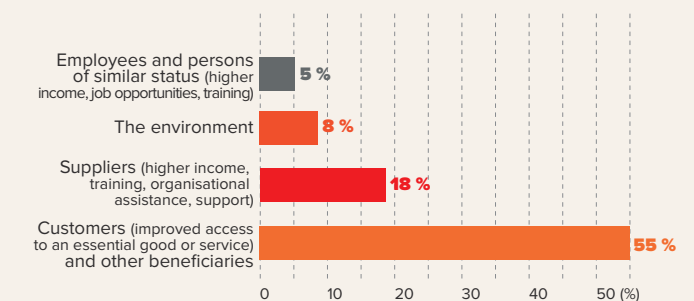
Sectors involved ▼



Source: AFD, 2015

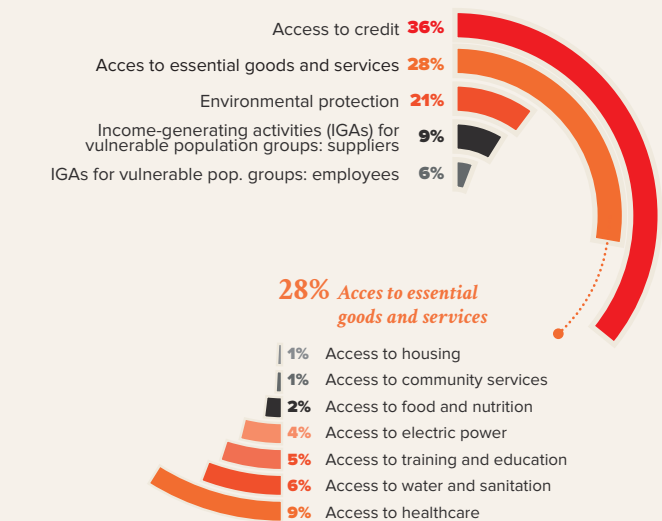
“A particularly striking feature of the social business projects in the study is their diversity.”

Social mission beneficiaries ▼



Source: AFD, 2015

Social purpose ▼



Source: AFD, 2015

1. Étude sur l'entrepreneuriat social à Madagascar, AFD Technical Reports, 2015.

2. In this paper, we use the term “social business projects”, because many of the ventures discussed do not (as yet) have formal company status.

3. Legal status was not considered a discriminating factor in this study, as it soon became apparent that organisations with a variety of statuses may contribute to a single social business project.

“It often requires imagination and a willingness to try out new business models able to generate incomes by tackling social problems.”

ACCESS TO FINANCING, THE FIRST CHALLENGE OF SOCIAL BUSINESSES ▼

A majority of the projects has an innovative nature. It often requires imagination and a willingness to try out new business models able to generate incomes by tackling social problems traditionally addressed by government policy and by targeting poor or disadvantaged social groups. However, it is extremely hard to line up financing for innovation, particularly in social matters, when the new idea has not been tested (given that the innovator can hardly guarantee that the project will go according to plan). In addition, a new product or service may have trouble pinpointing the correct market positioning strategy; it may find itself in competition with an existing commercial product or service or with offerings provided free of charge by charitable institutions. A common result of this early-stage financing problem – mentioned by all of the project owners surveyed – is that the project maturation process can be exceedingly long (in some cases up to 10 years). Obtaining funding for an innovative business model with no clear prospects of turning a profit is therefore the primary hurdle facing social businesses, in Madagascar and elsewhere.

CHANTING LEGAL STATUS, A COMMON PRACTICE ▼

A further observation is that a majority of the projects underwent a change of legal status over the course of their existence, although it should be noted that there is no equivalent to a social enterprise under the laws of Madagascar. Many projects start out with some kind of non-profit status (as NGOs, associations or cooperatives), but as their commercial activities develop over time, they become companies for regulatory and tax purposes. Company status, however, may not be ideal for projects still struggling to ensure that their social mission will be fulfilled, and each project has to come up with its own

“fix”: a company may have a charity as its majority shareholder, shareholders’ agreements may be signed or an ethics oversight committee set up, etc. A mismatch between activity and status can generate tax and regulatory issues that may jeopardise a project’s future.

KEY SUCCESS FACTORS FOR A SOCIAL BUSINESS ▼

It is better to focus in the initial phase on a single social objective (and a single target group) to avoid potential conflicting agendas that might require trade-offs. Once the project has broken even, its social scope can always be broadened.

The market positioning of the new product or service should be carefully planned in relation to those of potential competitors and the work of charities (based for example on serious market research conducted prior to project launch).

It is essential to make sure that the project’s legal status matches its activity and that the Articles of association reflect its social purpose (through legal engineering).

DRAWING LESSONS FOR DEVELOPMENT FINANCE INSTITUTIONS ▼

Early-stage social businesses have to contend with funding difficulties similar to those encountered by innovative start-ups, but with the additional handicap of not being able to promise high returns any time soon. This precludes financing from most conventional private sources. In many instances, incubator-style services would appear appropriate but financing them remains a major challenge in most developing countries.

Financing instruments and support programmes should therefore be tailored both to the type of sector and legal status involved and to the nature of the project initiator. An NGO will most likely require business and managerial assistance whereas an entrepreneur will be more in need of help in advancing its stated social agenda. ■

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ACCESS TO QUALITY SANITATION IN KENYAN SLUMS: SANERGY’S MODEL

Sanergy strives to leverage the entire sanitation value chain to create vibrant micro-businesses in informal settlements and by-products that can be marketed to Kenyan farmers. Hazardous waste is removed from local communities and converted into organic fertilizer and animal feed, for which there is high demand. However, experience has shown that all stakeholders need to derive benefit from each component of the business model to secure the community buy-in that is essential to the success of any local business.

The idea for Sanergy originated at Massachusetts Institute of Technology (MIT) when students were asked to develop a business solution to a poverty challenge that affects at least one billion people around the globe. Ani Vallabhaneni, Lindsay Stradley and I decided to leverage our previous experiences to develop a systems-based solution to the urban sanitation crisis. 4.1 billion people lack access to basic sanitation facilities (Baum *et al.*, 2013), resulting in one million deaths and USD 260 billion in lost productivity (World Bank, 2013) annually. Over one billion people currently live in urban slums, and this number is expected to double by 2030 (UN-Habitat, 2003). In Nairobi, 2.5 million slum dwellers rely on unsanitary practices such as “flying toilets”¹ and pit latrines.

Sanergy’s initial focus was on developing a dense network of pay-per-use toilets throughout Nairobi’s informal settlements and collecting and converting the waste into organic fertilizer and biogas. However, our focus gradually shifted in

two significant ways. First, we developed two additional distribution channels to reach a more diverse group of potential customers and to serve more customers based on their demands. In 2014 we began marketing toilets to landlords, who provide the facilities as a value-add service to tenants, and to schools. Second, we began experimenting with other ways of processing waste, and we developed a high-protein, pathogen-free, insect-based animal feed.

Since Sanergy’s inception in November 2011, our network has expanded rapidly. As of January 2016, we had removed and safely treated 7,590 tons of waste from the communities we serve. We have launched 781 Fresh Life Toilets run by 387 operators in eight informal settlements throughout Nairobi, and our network is used 31,700 times a day. Sanergy employs 251 people of whom 93% are Kenyan and 60% actually live in the slums. In an area with 40% unemployment, our Fresh Life Operators have created 147 additional toilet attendant jobs. For many of these people, this is the first formal employment they have ever had. →

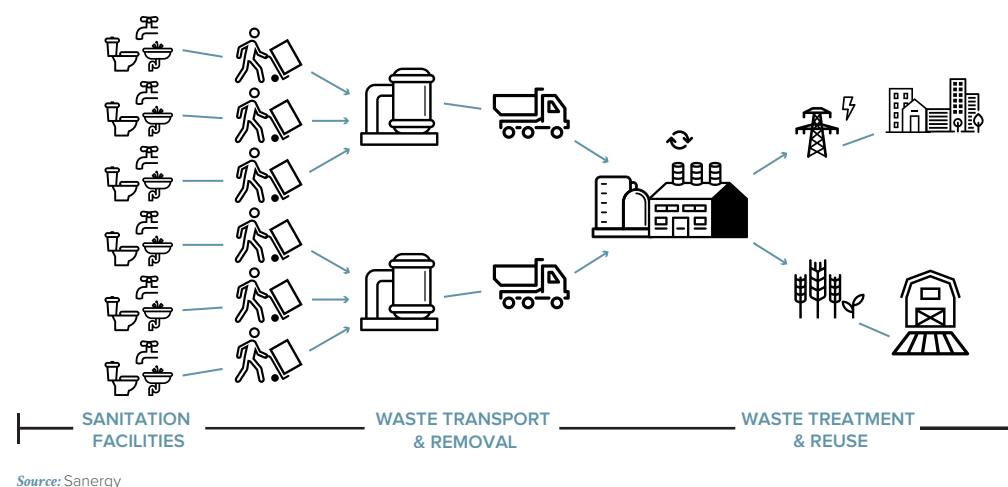


David Auerbach
CO-FOUNDER,
SANERGY



1 • Flying toilets refer to the habit of defecating into plastic bags that are then tossed onto the street.

➔ Building an integrated sanitation value chain



CREATING OPPORTUNITIES FOR THE ENTIRE SANITATION VALUE CHAIN

We incentivize participation in the Sanergy model by developing ways to make it economically beneficial to do so. Sanergy leverages the entire sanitation value chain to make sanitation provision profitable — and thus sustainable (FIGURE ➔).

for distributing and running our toilets in the community creates economic opportunities for slum residents to earn an income while improving the health and well-being of their friends, family, and neighbors.

As a social enterprise, we also strive to have maximum impact in the communities we serve, so we provide support services for our toilet franchisees and educate community members on the importance of good hygiene practices in general and hygienic sanitation in particular. In addition to improving community health, this increased hygiene awareness then creates more business for our franchise partners.

We have a unique hybrid structure, with a for-profit entity and a non-profit entity working in collaboration to achieve our mission. This structure has allowed us to diversify our funding sources, and we are able to work with an array of partners and funders to build healthy, prosperous communities. Most of our original funding came from competitions and other prizes, but we have robust and longstanding partnerships with a variety of investment funds, development agencies, and family foundations.

“The franchise model for distributing and running our toilets in the community creates economic opportunities for slum residents.”

We currently have three main streams of revenue generation: the sale of sanitation units that we have designed and manufactured for around USD 500 a piece; waste collection services for non-Sanergy service providers, primarily for producers of food waste; and the sale of by-products derived from human waste, primarily organic fertilizer and insect-based animal feed. The franchise model

DESIGNING PRODUCTS ADAPTED TO LOCAL NEEDS

We design and manufacture high-quality, low-cost sanitation units known as Fresh Life Toilets (FLT) using locally sourced materials and labor. We liaise closely with community residents to ensure we are providing a service they are willing to pay for and that their ideas are incorporated into our designs. For example, we learned that

community residents preferred completely tiled floors to a wooden frame around the squat plate and wanted mirrors and coat-hooks on toilet doors so we incorporated these features into the latest version of Fresh Life Toilets. Providing a service that residents are willing to pay for is crucial to addressing inadequate sanitation. Because our units use a cartridge-based collection system and have a small footprint (1 meter x 1.5 meter), they can be used anywhere.

DESIGNING VIABLE BUSINESSES FOR FRANCHISEES

We use three distribution channels for our toilets. First, we sell franchises to local residents known as Fresh Life Operators (FLOs) who run the toilets as a business, charging a nominal fee per use. These toilets are available to all and provide a clean hygienic alternative to public toilets and pit latrines. Operators set the price per use themselves based on what the market will bear (usually between 3 to 5 Kenyan shillings, on par with the cost of other sanitation options). In addition, we work with landlords to provide residents with access to safe sanitation within their compounds. Some have raised rents to pay for the FLT but most have found that increased occupancy rates due to enhanced appeal more than cover the cost of the toilet. Finally, through partnerships with the Kenyan Ministry of Education, Oxfam, and WASH United *inter alia* we have developed a robust program covering hygiene awareness and the installation of FLT in schools.

Community buy-in is critical to our business model, and we ensure that our FLT are viable businesses. FLOs can clear USD 1,000 in profit per toilet each year, and most own more than one toilet. Landlords have higher occupancy rates in plots with FLT and schools with FLT

report higher enrollment rates (increases around 20%) and attendance rates, especially among adolescent girls who frequently drop out of school once they start menstruating, often due to inadequate sanitation facilities.

We provide a variety of support services to our FLOs to ensure a consistent supply of quality sanitation facilities for customers and boost demand for our services. Receiving permission to access land is one of the biggest obstacles for FLOs. In informal settlements, both land ownership and planning permission are tricky issues. Sanergy's government relations team helps potential FLOs to deal with these complex systems and secure access to land by identifying the relevant authorities and drafting convincing requests that increase the likelihood of getting approval. Through a partnership with Kiva² we provide operators with 12- or 24-month interest-free loans to purchase toilets (which cost about USD 500 each). We require all new FLOs to attend business training where they learn relevant skills, including bookkeeping, toilet cleaning and customer service. We also host community marketing and edutainment events where we promote the Fresh Life brand and teach the importance of good hygiene. These events help drive demand for FLOs and hammer home the importance of hygiene in general. ➔

FOCUS SANERGY

Sanergy promotes sustained access to quality sanitation in informal settlements. It creates an efficient, equitable and sustainable sanitation cycle by building a network of small-scale sanitation centers (called Fresh Life Toilets) across slums, developing an affordable containerized waste collection infrastructure, and converting this waste at a central processing facility into organic fertilizer, insect-based animal feed and other high-margin products that address serious challenges in the agricultural sector.

2 • Kiva is a non-profit organization that connects lenders and borrowers on an online platform.

LOW-COST PRIVATE SCHOOLS SCALABLE SOLUTION TO A MASSIVE GAP?

In 2013, we launched an initiative to diversify our product offering and help FLOs grow their businesses by selling consumer durables at their toilets. Based on extensive research, we selected three products (solar lamps, water filters, and cooking stoves) and were confident of success, but after a three-month trial only

three cooking stoves had been sold. Our analysis revealed several flaws including product pricing strategy and payment plans, the reluctance of FLOs to up-sell to their customers and poor marketing of the new offerings. Ultimately however, the main lesson was that we should stick to our core business and what we know.

DIVERSIFYING REVENUE STREAMS THROUGH WASTE TREATMENT

Only about 10-15% of Nairobi's informal settlements have a functioning sewerage system so FLT's use innovative cartridges to store waste, ensuring that it does not harm the surrounding environment, and can be transported easily and safely. Sanergy's logistics team regularly visits each FLT to seal and remove the full cartridges, replacing them with clean, empty ones. The waste is then taken to our processing plant for treatment.

Collecting and removing waste is a key component of our business success, since it provides the raw materials for our primary revenue source. As we have expanded our network of toilets, we have optimized the waste collection service and have begun marketing our waste collection services to other local establishments, primarily to collect food waste, which we use to create animal feed.

Waste is converted into organic fertilizer known as Evergrow and an insect-based animal feed that we market to Kenyan farmers. This not only captures value from otherwise hazardous waste but also helps address agricultural challenges. The Kenyan Ministry of Agriculture has identified soil degradation as the primary threat to food security in the region and recommends that farmers spread 10 tons of organic fertilizer per hectare each planting season. With 27 million hectares of farmland in Kenya, there is a need for 270 million tons of organic fertilizer. Evergrow is one of the few products available to meet this enormous demand.

We market our fertilizer to small- and medium-sized farmers both through suppliers and directly. We find that direct selling is most effective as we can then provide tailored support and explain how to get the most out of the product. One of the challenges we have had to overcome is the reluctance of farmers to change their current practices or adopt new ones. In response, we have developed a robust team of knowledgeable sales professionals who talk to farmers about the demonstrated benefits of using Evergrow, including increased crop yields of between 30% and 100%. We also provide customer support services – primarily to smallholder farmers – covering sales advice, fertilizer application and follow-up.

As a social enterprise, we leverage each component of our business model to ensure maximum social impact and financial viability. It is vital to develop products and services that meet local needs, and the best way to do this is to involve potential customers in the design phase by conducting thorough market research. Moreover, by leveraging the entire value chain we have been able to incentivize participation and secure the community buy-in that is essential for success. Finally, we have realized the importance of diversifying our revenue streams to build multiple channels for community engagement and profitability (which we hope to achieve by 2018). Clogged, broken and unmaintained toilets are almost worse than no toilets at all. To keep the community engaged in the Sanergy solution, it is vital to have a profitable – and thus sustainable – solution that provides everyone with hygienic, dignified sanitation over the long term. ■

To provide low-cost nursery and primary school education in poor neighbourhoods, Bridge International Academies has developed a vertically-integrated system. It includes operational tools and systems, curriculum materials, teacher recruitment, training processes. Its business model gives priority to academic quality using new technologies to support classroom teaching while keeping overheads and costs down in order to remain affordable.

Are social businesses able to provide efficient, sustainable, scalable solutions to problems that have traditionally been the preserve of the public sector? While few will argue that commercial businesses are the key to creating and sustaining jobs, many consider that a line has been crossed when for-profits enter sectors traditionally seen as public goods like nursery and primary education.¹ Indeed, the UN special rapporteur on education, Kishore Singh declared that “For-profit education should not be allowed in order to safeguard the noble cause of education”.² Yet there is a significant gap that needs to be addressed. Unicef estimates that there are still 58 million primary-age students globally who are out of school (UIS/EFA GMR, 2015). A recent article by Bookings Fellow Leisbet Steer reports that USD 26 billion in donor funding is needed every year to address this global education gap (Rose *et al.*, 2013).

However, according to Professor James Tooley from Newcastle University (Tooley *et al.*, 2005), a surprisingly high proportion (50-75%) of school-children in low-income areas attend low-cost private schools and their academic performance is markedly better than their peers in state schools. This led Tooley to conclude: “Rather than assume that the private unaided education sector is a problem, we should see it as a great strength. [...] Its existence and flourishing should be a cause for celebration.” Families living on USD 2 per day spend USD 51 billion a year worldwide on private nursery and primary education. If the private sector can provide affordable, high-quality education for these children, surely this is a good thing. Private schools mobilize new sources of capital and are inherently accountable to parents as customers. Moreover, if they can generate learning gains for less than current government budgets, surely the related innovations in both teaching and management can benefit all. →



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2. Quoted from the presentation of a report to the UN General Assembly, October 27, 2014, <http://www.ohchr.org/en/NewsEvents/Pages/DisplayNews.aspx?NewsID=15221&LangID=E>

**FOCUS
BRIDGE**

Bridge International Academies provide nursery and primary school education for 100,000 African children whose families live on less than USD 2 per person per day. It also hopes to expand into Asia. It seeks to deploy data-driven and technology-enabled teaching methods. Bridge also tries to forge partnerships with governments and other NGOs to solve core education challenges, from teacher accountability to children's learning gains.

Bridge International Academies opened its first school in Mukuru informal settlement in Nairobi, Kenya in 2009 with the aim of expanding access to affordable high-quality primary education for poor families. Bridge currently operates 460 schools serving more than 100,000 pupils in Kenya, Uganda and Nigeria. Their students in Kenya obtain better results than their peers in neighboring schools and total tuition per child averages USD 74 per year, which allows a family living on USD 1.25 per day to send 3 children to school while spending only 10% of the families' income.³ Bridge seeks to leverage data, technology and scale to reorganize the education life cycle. It

claims to have developed a comprehensive model that includes operational tools and systems, curriculum materials, teacher recruitment and training processes in order to build, manage and replicate affordable, high-quality schools. Small-scale operators would find it hard to secure the investment required to train teachers and deliver affordable quality education to families living on USD 2 a day per person, or even less. Such investment would need to be spread over a sufficiently large number of pupils and would come with high risks. Bridge International Academies was founded on just such a mass-market premise.

USING TECHNOLOGY TO REDUCE COST AND BOOST PERFORMANCE

Technology lies at the heart of Bridge low-cost business model. Indeed, Bridge hires and trains teachers from the community. Most do not have government certification and all are carefully assessed before they can get onto the residential training program. The Company has also hired and trained more than 5,000 academic staff. The teachers are supervised and supported by technology tools and this generates considerable savings in overheads as well as boosting pupil performance.

Each Bridge International Academy has only one manager and most non-instructional activities (billing, payments, expense management, payroll processing, prospective admissions, etc.) are centralized and automated via smart-phone and tablet applications connected to a custom backend ERP (Enterprise Resource Planning) system. This frees up Academy Managers to focus on more critical local work such as overseeing classroom instruction and managing relationships with parents and the local community. Technology is also driving better learning outcomes by addressing two root causes of failure: teacher absenteeism and lack of training.

Bridge's technology allows a central academic team composed of former teachers to plan lessons across all subjects and grades based on the national curriculum. This team drafts teaching guides to help classroom teachers teach content more effectively. These master teachers use smart phone applications and tablets to transmit

“Technology is driving better learning outcomes by addressing two root causes of failure: teacher absenteeism and lack of training.”

lessons (by subject and grade) to 5,000 classroom teachers for each day's lessons. Lessons are combined with custom learner materials such as course textbooks, additional reading and classwork and homework books. Teachers must sync up devices to receive lessons so this process guarantees their attendance. This accountability together with readily-available lesson plans helps keep teacher absenteeism

much lower than the 47% national average in Kenya (less than 1% on average in Bridge schools). The same devices also allow teachers to transmit student assessments to a cloud server and to analyze areas where a critical mass of students have missed a question or struggled with a concept. The related feedback helps “master teachers” determine where to adjust lesson plans.

PRIORITIZING TO STAY AFFORDABLE

Focusing investment on delivering optimal learning gains and holistic child development is core to ensuring that families living on USD 1.25 per day can afford to send all of their school-age children to school while spending only 10% of their income. It is therefore necessary to focus on certain aspects more than others. Bridge prioritizes academic quality over infrastructure attractiveness. It teaches out of simple, safe buildings to keep budgets down. To give an example, Bridge spends millions of dollars per year on academic Research & Development (R&D) but purchases wire frames for windows instead of glass panes. The board at the front of the class is a chalkboard, not a whiteboard. There is often neither the capital nor the land available for a private playground. Bridge partners with other government and church institutions and private individuals to get access to playing fields. However, Bridge also focuses on non-academic child development. In 2015, 3 of the top 10 National Choral groups in Kenya came from Bridge International Academies. Bridge focuses on encouraging dynamic extra-curricular activities that do not require expensive equipment or extensive space.

“Bridge prioritizes academic quality over infrastructure attractiveness.”

Bridge's priority is to deliver high learning outcomes. Based on the results of USAID-designed exams administered by an independent monitoring and evaluation company, Bridge pupils learn 32% more English and 13% more in math in one year than their peers in neighboring schools learn in two. The success of Bridge – and other low-cost private schools – ultimately resides in an alignment of interests. Parents are customers who must be satisfied in order for the school to survive and grow. Bridge aspires to build a brand that delivers high learning outcomes in a positive environment. If they cannot do this, the company will fail. If they can, Bridge will grow and generate profits that fuel further growth. The incentives of the customers and the company must be aligned. ■

**FOCUS
NOVASTAR**

Novastar manages an USD 80 million venture capital fund dedicated to finding and growing the “new stars” of East Africa. Founded in 2014, Novastar backs early- and growth-stage businesses led by entrepreneurs with the capability and ambition to transform markets at the base-of-the-pyramid. These enterprises address proven demand for basic goods and services with innovative business models that widen access, improve quality, and lower cost of basic goods and services for the aspiring mass market.

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THE POINT OF VIEW OF AN IMPACT INVESTOR

REDEFINING THE CONCEPT OF RISK



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The notion of a trade-off between financial, social and environmental returns has dominated the impact investing debate up to now. Bamboo Finance views these components in terms of a total return that needs to be maximized and it does not believe that profits have to be sacrificed in return for a greater social and environmental impact. It claims that it is possible both to maximize profits and achieve social and environmental benefits by investing in the equity of businesses that provide essential products and services to low and lower-middle income consumers in emerging economies.

Low-income households in emerging markets are already consumers of essential goods and services (healthcare, energy, financial services, agriculture for example), but they often pay dearly for very poor quality. Access to new and / or improved products and services can have an immediate positive impact on their quality of life. The social, environmental and economic impact can be intrinsically linked to the products and services, and profit and impact objectives can be achieved simultaneously. A trade-off is not necessary.

It is important to note that impact investing is still in its infancy. Certain sectors are ripe for investment but others are still testing the viability of business models. Microfinance was among the first sectors selected for impact investment. New financial services models have emerged to serve the unbanked more effectively and financial services for low-income consumer remains a high growth, high value and high impact sector. Bamboo Finance's investment in the Mongolian TenGer Financial Group is a case in point (BOX 9) and there are also enormous social and environmental impact investment opportunities in clean energy, agriculture and healthcare.

Bamboo Finance believes it is possible to generate a "total return" by narrowing an investment universe down to specific markets and sectors. By investing in companies that provide access to high quality, affordable products and services for low-income customers, profitability and impact performance can grow in tandem but, as with financial performance, impact performance needs to be measured consistently. This means liaising with an investee to determine the best approach and adapting this as necessary. →



A SUCCESS STORY OF IMPACT AND RETURN

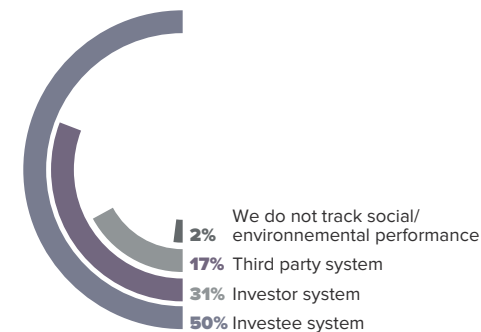
In 2009, Bamboo Finance took a stake in the Mongolian TenGer Financial Group (TFG). Xac Bank – TFG's core business – started as a non-profit microfinance lender in 2001 and evolved into the fourth largest bank in Mongolia offering loans mortgages and mobile banking services to small and medium-sized businesses. By 2013, Xac Bank had become a fully regulated commercial bank renowned for its transparency, good governance and fair lending practices with over 500,000 customers in 21 provinces, 97 branches, and USD 800 million in total assets. The bank markets impact products (green loans, micro insurance and a wide range of savings products). TFG's growth enabled Bamboo Finance to exit by selling its stake to a group of investors led by ORIX Corporation, the largest leasing company in Japan and third largest world-wide. When it exited TFG, Bamboo Finance managed to double its money and exceed the targeted 20% Internal Rate of Return (IRR). Taken together, these metrics represent the "total return."

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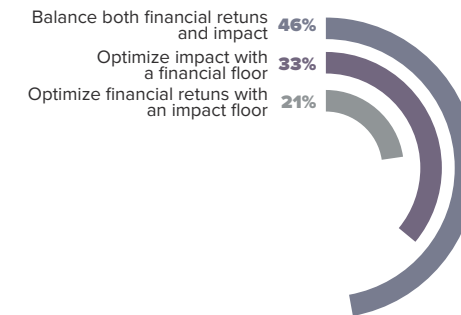
A FEW FIGURES ABOUT IMPACT INVESTORS ▼

Impact measurement system ▼



Source: GIIN, J.P. Morgan, 2011
Methodology: data were collected from 52 impact investors.
They chose one answer.

Investment thesis ▼



Source: GIIN, J.P. Morgan, 2011
Methodology: data were collected from 52 impact investors.
They chose one answer.

When Bamboo Finance evaluates an investment opportunity, it assesses not only the potential financial risk and return, but the measurable social and environmental risk and potential for value creation. An investment with high potential profits but unsustainable social and/or environmental approaches will be sub-optimal and will fail Bamboo Finance's impact investing "efficiency frontier."

To apply a "total return" approach, Bamboo Finance begins by determining whether a potential investment provides essential goods and/or services affordably to unreached or underserved low-income communities and whether the product/service enhances quality of life and/or efficiencies that translate into increased income or reduced costs for the communities in question. Once an investment meets these criteria, Bamboo analyzes the operations, business model, management, governance and financial performance as well as the macro-economic context (GDP growth, political stability and regulatory environments, etc.). It works with investee management teams to forge a shared vision of financial, social and environmental performance over the life of the investment (between 5 and 8 years for private equity investments).

Bamboo works with investees to map impacts and track these on a quarterly basis alongside financial performance. It sits on investee boards

and committees and links its own performance as impact fund manager to the investee's financial and impact performance. It also measures and monitors financial and impact performance at the portfolio level.

“The time has come to redefine (...) return to include the benefits of social and environmental factors.”

To reflect this vision in the organization, Bamboo's performance incentive comprises financial carry and impact-based carry. It is also committed to pooling experiences and best practices. The time has come to redefine "risk" to include factors that are detrimental to the future of our planet and continue to promote inequality and exclusion, and to redefine "return" to include the benefits of social and environmental factors.

A growing number of investors and their clients are starting to question the impact of their investees as witnessed by the growing momentum of the Divest/Invest movement and recent pledges concerning climate change and impact investing. Investment capital has a central role to play in the fight against global poverty, climate change and peace. Maintaining business as usual is a risk we can no longer afford. ■

FOCUS BAMBOO

Bamboo Finance is a private equity investor in businesses that provide essential services to low-income consumers and in emerging markets. Its market-based approach delivers social and environmental value and it has a proven record of providing attractive financial returns. Bamboo currently has USD 280 million under management, representing a portfolio of 38 investments in more than 20 countries, providing 16 million customers with services and creating employment for more than 20,000 people. It has offices in Luxembourg, Geneva, Bogota, Nairobi and Singapore.

SOCIAL BUSINESS: THE CHALLENGE OF SCALING UP

Entrepreneurship can meet the needs of “base-of-the-pyramid” populations, provided the business in question has reached the critical size needed for profitability and sustainability. Examples of “inclusive businesses” which have successfully “scaled up”, however, are few and far between. Rectifying this situation means removing a number of practical, psychological and financial barriers. There are many ways in which development finance institutions can help this sector to grow.



Olivier Kayser
FOUNDER AND
CEO, HYSTRA



Robin Bonsey
CONSULTANT,
HYSTRA



What role can businesses play in combating socio-economic inequalities and environmental depletion? This key issue in the current debate over development straddles three relatively independent phenomena. First, with financial resources now limited or reduced, authorities and private foundations are looking for leverage that will boost the impact of their actions. Their watchwords now are social-business support, public-private partnerships and impact investing. The second phenomenon is the 2008 financial crisis which triggered a moral conflict in many business leaders seeking to reconcile their responsibilities towards their shareholders with their personal convictions. Here the watchwords are inclusive business, shared value and base-of-the-pyramid. The third phenomenon applies

to NGOs, non-profits and social entrepreneurs who wish to sustain their initiatives and reduce their dependence on ad hoc resources such as grants and donations. Their watchwords are social business, sustainability and “turning beneficiaries into customers”.

While the outlook, ideologies and vocabulary differ, the key question is the same, i.e., can businesses – long considered the source of social and environmental problems – become part of the solution? Are there any concrete examples which prove that inclusive business¹ approaches can solve social problems in an economically profitable way and on a large scale? While inclusive businesses may have sprung up in developing countries, we need to ask ourselves why they are not more widespread? What obstacles do they encounter when changing scale and what can development finance institutions do to help them grow?

1 • Defined as a commercially viable business that provides low-income communities with products and services to which they did not previously have access.

SUCCESS OF SCALING UP: EXAMPLES OF FOUR INCLUSIVE BUSINESSES

The following examples of inclusive businesses prove that scaling up is indeed possible. The businesses in question have reached a critical size that ensures both profitability and sustainability. They also directly impact a huge number of customers and have inspired the creation of similar businesses.

Grameen Shakti, a subsidiary of Grameen Bank, distributes domestic solar energy systems and helps households to purchase them through an independent loan scheme. This non-profit organisation is now a commercially viable business. For a system capable of powering four lamps, a few mobile telephones and a television, for example, customers can either pay USD 250 in cash or make a down payment followed by monthly instalments over three years. The service includes a monthly maintenance visit. With a total of 1.5 million household solar energy systems installed as of June 2014, some 13,000 employees and a network of 1,300 village antennae, Grameen Shakti can justifiably claim to be one of the world’s largest social businesses. It has received public grants but its economic model is now sustainable. Its success has spawned many competitors, some of which operate for profit.

JAIN started out as an agricultural machinery supplier in India in the 1960s selling micro-irrigation systems to small farmers and helping them to double their yields while at the same time safeguarding the country’s water resources which were being jeopardised by the Green Revolution². Realizing that farmers could not always find a market for their additional produce, JAIN diversified into buying

and processing agricultural staples and then developed its own range of products, offering farmers fertilisers and seed and loans to purchase farm equipment. JAIN has worked with over four million smallholder farmers in India and in 2014 it posted revenue of more than USD 400 million (Hystra, 2015).

During Mexico’s recession in the 1990s, the directors of CEMEX, a global leader in the cement industry, realized that poor neighbourhoods were continuing to buy bags of cement despite the halt in commercial building work. CEMEX sent several employees into the shantytowns of Guadalajara to get a better understanding of this phenomenon and they discovered that the local home improvement process was very slow and inefficient. It took a family four to five years to add a room to their house, with an average of 40% of materials wasted. Furthermore, the resulting buildings were of very poor quality. CEMEX’s Patrimonio Hoy programme facilitates the self-build construction process through a comprehensive package that allows customers to build a 10 m² room in 70 weeks at a cost of USD 1,000, divided into weekly instalments of USD 17. This covers technical assistance in designing the room and compiling a list of materials needed, organising the project into stages and providing advice on building techniques. In 12 years, the Patrimonio Hoy programme has benefited more than 380,000 families. Not only is this a remarkable social business success story, it is also one of CEMEX’s most profitable distribution channels. With more than USD 45 million in sales in 2011 (40% of which comprised CEMEX building materials), the programme brings in several million dollars in additional profit each year. →

FOCUS HYSTRA

Hystra is an international consulting firm which designs hybrid strategies and innovative economic models combining profitability and strong growth potential. In particular, the firm conducts in-depth studies of sectors such as energy, water, housing and nutrition, focusing on market-based approaches to benefit low-income communities. Since its establishment in 2009, Hystra has worked with some 50 clients in more than 20 countries.

2 • The “Green Revolution” is a policy to transform farming in developing countries and to boost agricultural production through the use of fertilizers, irrigation and high-yield varieties of grain.



Codensa has been supplying power throughout the city of Bogotá since 1997. The electrification rate within its concession area is 99%. In 2002 the company realised that poor customers were using very little electricity because they had no cash to buy electrical appliances and no access to consumer loans.³ The company therefore created Codensa Hogar to offer consumer loans to the neediest households. The loan offering was so successful that by 2009 Codensa had carved out a 33% share of Bogotá's electric appliance market. Not only

was Codensa able to assess the credit risk of its customers by looking at the payment history of their electricity bills, it was also able to add loan payments to electricity bills at a very low marginal cost.

These four examples demonstrate both the social impact potential and the profitability of inclusive businesses. However, they also show that patience and determination are required to run these types of business: with the exception of Codensa, the above models took between five and ten years to prove themselves.

OVERCOMING OBSTACLES TO SCALING UP

As inclusive businesses expand, they cross three thresholds, meaning they have three obstacles to overcome. Firstly they must go from being technologically innovative to commercially successful; then they have to leverage the skills and resources needed to reach the size at which their model will be profitable in a given geographical market. Finally, they need to secure the buy-in of local and international actors who can replicate their business model on a larger scale.

“Solar lamps, optimised ovens and water filters could improve the lot of millions of people for between just USD 20 and USD 40.”

First off, “good” products are not getting to the markets where they are needed because traditional marketing and distribution methods are

ineffective. There are many well-developed, affordable products capable of improving the life of base-of-the-pyramid [BoP] populations. Solar lamps, optimised ovens and water filters, for example, could improve the lot of millions of people for between just USD 20 and USD 40. However, far too few BoP families are buying these products. Although engineers have done their job by designing affordable products, the challenge now lies in promoting and distributing them. There is no doubt that marketing to BoP populations requires very specific methods; it is not merely a question of preferring one solar lamp brand over another, but rather of deciding to replace a polluting oil lamp, which is expensive yet familiar, with a solar lamp that is bright and clean yet unfamiliar.

The “last-mile challenge”⁴ is not just a challenge of physically delivering innovative products but also of advertising, explaining and financing these as consumers are either unaware of their existence or sceptical about their benefits (Hystra, 2013).

Next, the models that work do not attain the scale needed to become profitable because of ideological barriers and lack of resources. Social entrepreneurs rarely combine both innovator and business leader skills and they are even less likely to realise just how tight a bond they have with their company.

Their passion is for creating something bespoke rather than planning, streamlining and even mass producing their model for it to grow. For many social entrepreneurs, scaling up is synonymous with choosing between quality and quantity; some microfinance institutions, for example, refuse to accept purely commercial capital to grow their operations. Moreover, there are very few companies with both the true social value and investment opportunities needed to meet the expectations of traditional financiers. Investing in social business has no defined exit strategy and is often complex and subject to very high transaction fees (investor start-up and operating costs can account for 20% to 50% of invested capital). Social businesses need

much more than financing to be able to develop and succeed: they need more complex support and technical assistance than that required by a traditional business.

“Social entrepreneurs rarely combine both innovator and business leader skills.”

Finally, these ideological barriers to growth and the lack of resources mean that social entrepreneurs who have been successful in their own country are not necessarily going to be able to replicate their model in other countries. Multinational corporations that could do so are often either unaware of existing models or unable to do something similar because they require a faster return on investment. Moreover, they may be reluctant to jeopardise their own products by offering cheaper alternatives (Kayser and Budinich, 2015).

THE ROLE OF DEVELOPMENT FINANCE INSTITUTIONS

Development finance institutions can help inclusive businesses cross these three thresholds: they can take risks, invest in common goods (methodologies and databases) and lobby governments.

Social businesses around the world are managing to find ways to market and distribute to BoP populations using iterative development

approaches and imagination. Nevertheless, the lack of communication between sectors, countries and continents prevents best practices from being consolidated and condemns everyone to constantly “reinventing the wheel”. Authorities have a role to play in ensuring that good business practices are shared and disseminated. Methodologies and other benchmarking tools could be disseminated to social businesses worldwide via technical assistance funds. →

3 • More than 65% of Codensa customers had no bank accounts and no credit history.

4 • The “last-mile challenge” generally refers to the logistical difficulty companies face when distributing their goods and services to “base-of-the-pyramid” consumers, especially in rural areas.



USING MEASUREMENT TO ENHANCE AND SHARE SOCIAL BUSINESS PRACTICES

“If the company in question is successful and the concept proves effective, other more traditional investors will be willing to step in and finance the development of other companies wishing to enter the same market.”

High impact – albeit risky – investment opportunities must be identified to help proven models maximise their market potential and this is clearly something local branches of development finance institutions could do.

which distort the energy market and hinder the adoption of cleaner energies. They can also help develop new standards to encourage the creation of social businesses. For instance, regulating the quality of drinking water sold by small purification plants would protect consumers and maintain their trust and safeguard the longevity of these businesses.

Finally, proven models could be replicated more quickly by setting up a platform to “import” them into a given country. Once the requisite social and environmental challenges have been analysed (e.g., access to drinking water in rural areas, infant nutrition and urban sanitation), solutions that have proved effective in other countries must be identified and systematised. Entrepreneurs capable of replicating them then need to be found: the DNA of these businesses would then be passed on to local companies or individuals in the same sector that would develop them locally. Close monitoring, extensive technical assistance and appropriate financing solutions would be needed to launch and then expand businesses replicated in this way.

This strategy of relying on a proven model would speed up the launch of social businesses and reduce their risk of failure. Investing in just such a collaborative approach based on reproduction and strong social impact must be included in the mandates of public-sector development bodies.

▼ The simultaneous transformations at work in the business world and non-profit, philanthropic and public sectors are creating new opportunities for involvement. The challenge for stakeholders in public-sector development is to understand all these changes in the development ecosystem and define the particular role they can play. ■

Development action mandates should also allow these institutions to support pioneering ventures trying to break into new markets or to develop new products with strong social impact but higher risks. If the company in question is successful and the concept proves effective, other more traditional investors will be willing to step in and finance the development of other companies wishing to enter the same market. In addition to financing existing projects, development finance institutions and public funding providers can help dismantle many of the regulatory barriers which are a major obstacle to start-ups.⁵ This might involve encouraging the amendment or elimination of excessive or obsolete regulations such as an import tax on socially useful products that cannot be manufactured locally (on solar lamps, for example, which are mostly mass-produced in China). Development finance institutions can also encourage the abolition of public subsidies on fossil fuels (petrol and gas)

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To achieve credibility, social entrepreneurship must spell out the basic principles underlying its practices and objectively measure its outcomes. Measuring social performance – particularly by analysing management practices – is an eminently suitable approach for social business. A key challenge in this respect is designing standardised tools that reflect the special requirements of this sector.

Social businesses have attracted an enthusiastic following among corporate foundations, multinationals, investment funds, the media, public policymakers and NGOs alike. Social business aims to implement concrete, innovative, sustainable solutions to social problems – from access to renewable energy in areas covered insufficiently or not at all by the electric power grid to the fight against infant malnutrition. Where its proponents often differ however is on how to achieve the desired results. Taking their lead from Muhammad Yunus, who articulated the principle of “No loss, no

dividends”, a number of social entrepreneurs have stressed that social objectives must take precedence over financial objectives. Others claim that it is enough to give the two equal status, or that the main issue is simply to set explicit targets in advance for both kinds of goals. But everyone seems to agree on the crucial need to measure social achievements. Otherwise, it is hard to see how these organisations can monitor or enhance the impact of their work on the social or environmental problems they seek to address. A failure to clearly identify the intended outcomes could well undermine the credibility of social businesses – and their *raison d’être*.



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THE NEED OF SOCIAL PERFORMANCE MEASUREMENT

Microfinance has become popular as a means of combating poverty by enabling small entrepreneurs – often operating in the informal economy and lacking access to the financial system – to make it on their own. An influx of public funding into this burgeoning sector has led to rapid commercialisation and, in some cases, to practices that bear little resemblance to the initial purpose of micro-

finance, including private appropriation of public funds, larger loans at higher rates and over-indebtedness. The fight against poverty has gradually been supplanted by the notion of financial inclusion, often with detrimental consequences for the poorest recipients. As the microfinance experience strongly suggests, any sector that claims to meet both social and financial goals but fails to outline its underlying guiding principles risks veering off-track. ➔

5 • A business trying to change the regulatory framework through lobbying may be suspected of conflict of interest but this would not be the case for a public body.

➔ The impact chain



This highlights the importance of establishing clear non-financial assessment criteria for social businesses and identifying the practices most conducive to achieving social objectives. But before we go about the vital task of measuring the work accomplished by organisations, we need to clarify the actual purpose of measurement. Are we concerned, for example, with the effects of selling solar lamps to poor population groups or rather with steering indicators – in which case we would focus more on “social performance”, i.e., on management practices in place? It is important to distinguish between these two levels of analysis: i.e., measuring social impact or measuring social performance (the latter being much better suited to social businesses).

“It is important to distinguish between these two levels of analysis: i.e., measuring social impact or measuring social performance.”

FOCUS CERISE

CERISE is a non-profit service provider based in Paris with 15 years of expertise working in microfinance, social business and rural finance. It offers training and support to both large and small institutions wishing to carry out social audits, analyse social data or devise their own social strategy. In addition, CERISE draws on the experience of its members and partners to co-develop user-friendly tools and resources that are available free of charge.

Measuring social performance means assessing the extent to which an organisation has planned for achieving its social purpose in the long term. That requires analysing the organisation’s mission and reviewing its policies and procedures as well as examining the clarity, consistency and relevance of what is often termed the “theory of change” – in other words, the changes the organisation expects to achieve and how it believes the actions it has planned will bring these changes about. This ensures that each of the first links in the impact chain – from inputs to outputs – is sufficiently robust (FIGURE ➔). Social performance measurement is a concrete activity carried out under the direct stewardship

of the organisation. It helps the organisation’s policy-makers and partner institutions to make operational decisions and strengthen and adjust existing practices whenever these appear to be going astray. The resulting framework makes it possible to identify key performance indicators, or KPIs (profiles of beneficiaries, shared governance, satisfaction, product adoption rates, quality, etc.) that provide a basis for regular and relevant impact reporting.

In contrast, social impact measurement seeks to tie changes for end-beneficiaries back to the social business actions (BOX ☞). When we focus on quantifiable measurement of a social business impact, we are confronted with the thorny issue of how to treat the changes observed. For example, if the income of a group of producers has gone up, should this increase be ascribed to the action of the social agribusiness to which they deliver their output or to an upturn in the local economy?

In any event, impact measurement – a process involving a cumbersome research protocol – is a more occasional practice, typically conducted with outside financing and input from outside experts. A social purpose organisation does, however, retain control over the assessment and monitoring of outcomes and observed changes using KPIs to ensure effective implementation of the organisation’s theory of management – for example, the number of solar lamps sold, profiles of beneficiaries and their level of satisfaction. These processes can subsequently be checked (as in the microfinance industry, for example) by rating agencies that may systematically and independently assess to what extent the organisation is fulfilling its social mission. Such external verification enhances the credibility of the organisation’s internal efforts and helps it communicate more effectively with partners.

STANDARDISATION, A PROCESS REQUIRING MATURITY

In the measurement process, a question that often crops up is comparability. How do the outcomes achieved by an organisation stack up against those of another organisation, or the a peer group average (i.e., organisations with a similar purpose, structure and environment)? That question cannot be answered unless the methods and indicators used to track progress have been standardised.

The idea is to be able to compare organisations in terms of impact and, more importantly, to provide a common language that renders a set of good practices intelligible based on the maturity of the specific sector and the sharing of experience. Standardisation establishes a “compendium of existing practices” that includes all of the component parts and devises a metric for assessing outcomes that is relevant to an organisation’s specific purpose. An organisation may elect to apply sector-based benchmarks, scale down its reporting and communicate in a consistent, directly intelligible fashion with its funding providers and external partners. The work of the Social Performance Task Force¹ –

which produced the Universal Standards for Social Performance Management with microfinance professionals – is exemplary in this regard.

“The idea is to be able to compare organisations in terms of impact and, more importantly, to provide a common language.”

A decade of sharing experience and collaborating has enabled microfinance practitioners to develop both the Universal Standards and a social performance assessment tool called SPI4. The microfinance experience underscores the power of such approaches to drive organisations to improve their own social practices and design appropriate assessment tools – most notably by managing their processes and outcomes with the help of social scorecards which they share with their staff and their boards of directors. The Universal Standards serve as both a manual of good practices and an assessment framework. ➔



IMPACT ASSESSMENT METHODOLOGIES

Some impact assessment methodologies are chiefly quantitative; they involve statistically comparing the characteristics of a representative group of beneficiaries with those of a control group composed of individuals whose “only average difference” with the experimental group is that they are not subjected to the action of the organisation. A further distinction runs between “quasi-experimental” methods (*ex post* construction of the control group) and experimental methods or Randomised Control Trials (RCTs) with *ex ante* construction of a counterfactual (random assignment of individuals who will or will not benefit from the organisation’s actions). In contrast, qualitative methods tend to use modes of sampling that emphasise diversity rather than representativeness, along with anthropological and sociological research protocols (interviews, observation, “triangulation” of data) to analyse life trajectories, relationships between stakeholders and complex socio-economic systems. Lastly, we find mixed methods straddling quantitative and qualitative approaches. To establish causal links, such methods combine quasi-experimental with qualitative techniques (Bédécarrats, 2012).

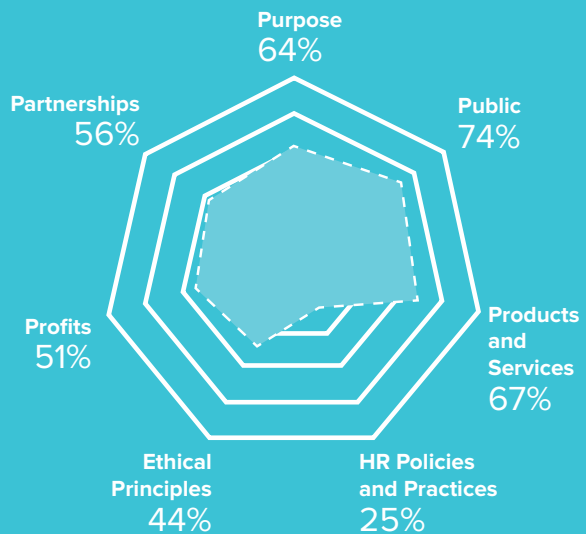
¹ The Social Performance Task Force (SPTF) is a membership organization with more than 2,600 members involved in inclusive finance (practitioners, donors, investors, associations, technical assistance providers, rating agencies, researchers, regulators, etc.). SPTF engages with stakeholders to develop, disseminate, and promote standards and good practices for social performance management and reporting.





THE SOCIAL BUSINESS SCORECARD (SBS)

The Scorecard is structured according to seven independent dimensions called the 7 P's. A social business has a **Purpose** – a clear social mission shared by all stakeholders. A social business targets a **Public** that is vulnerable, poor and/or excluded (clients, suppliers and/or employees), and the **Products and Services** it offers form an adapted mix that meets basic needs and reduces inequalities. A social business has **HR Policies and Practices** that ensure employees and service providers are treated responsibly. A social business adheres to **Ethical Principles** regarding the environment, the community and integrity. A social business has a defined and transparent policy on **Profits** and how they are used to further the social mission. **Partnerships** are a last, optional point. When a social business benefits from a partner relationship, the technical support provided is fundamental to the business model. The seven points in the SBS are subdivided into some fifty management practices spanning a broad range of organisational profiles. Completing the Scorecard requires documentary analysis and interviews with people in the organisation and its partner organisations (service providers, suppliers, funding providers, clients, etc.).



CERISE'S SOCIAL ENTREPRENEURSHIP ASSESSMENT TOOL

The popularity of social business and impact investing has gradually given rise to a variety of approaches and tools for assisting social enterprises. For example, the *Practical Guide to Measuring and Managing Impact* (EVPA, 2015) proposes a five-step framework for integrating impact measurement into the organisation's operations so that impact assessment becomes an integral part of the management process (for the organisation) or the investment process (for the funding providers). Similarly, the Organizational Capacity Assessment Tool (OCAT) developed by McKinsey² helps non-profits assess their operational capacity and identify areas for improvement.

Based on insights derived from the microfinance industry and the real-life experience of social businesses, CERISE, the knowledge exchange network, has developed a special tool called the Social Business Scorecard (SBS³). The product of a three-year iterative process undertaken by CERISE and the working group it heads up,⁴ the SBS analyses the distinguishing features of social businesses with the aim of enhancing the assessment and management of their social performance. It is structured around seven "dimensions" (the 7 P's) that are subdivided into some fifty management practices (BOX 9). The Scorecard's standardised nature makes it easier to assess social performance, shape strategic and operational policies and introduce programmes to improve management practices.

In early 2015, twelve organisations in six countries across three continents made use of the SBS – thanks in large part to support from Agence Française de Développement (AFD) and efforts by CERISE and its partners. One such organisation is a development NGO in Togo dedicated to tackling rural poverty. It has three programmes in place: providing instruction for small farmers in how to increase agricultural yields; construction and management of community clinics; and a mutual health insurance scheme that covers 75% of each member's healthcare expenses. As a result of the programme, the NGO's beneficiaries can get faster medical treatment throughout the year, leaving them more time to tend their farms and generate income.

However, a finer-grained analysis of the current beneficiaries highlighted a lack of information that would guarantee continuity among the three services provided. For example, the mutual health insurance scheme – a recent, pioneering programme that is inadequately understood by the local population – has attracted more traders and teachers than farmers. These findings prompted the NGO to track a number of indicators systematically so as to ensure proper targeting and adjust its promotional campaigns to the profiles targeted.

The SBS can also help strengthen human resource policies in ways that consolidate an organisation's social purpose. A case in point is a social business in Madagascar that works with a network of women service providers distributing food to combat infant malnutrition. The SBS analysis highlighted the fact that the role played by these women had been underestimated. They do very hard underpaid work with no entitlement to social insurance. Moreover, while the distributors embodied the organisation's public image, they were only vaguely aware of what made the programme special. Moreover, because the women rarely stayed long, the enterprise was constantly obliged to train new people. The situation only began to change once the results of the SBS analysis were presented to the organisation's leadership. The previous service agreement approach, with sales commissions as the distributors' sole compensation, was replaced by salaried employment that included benefits and training. Given that this strategic choice required substantial expenditure, the organisation extended the time limit it originally set for breaking even so that it could build up adequate human resources. Since these changes were made, the enterprise has noted greater levels of satisfaction and lower turnover among distributors, as well as improved delivery of its message to the designated beneficiaries.

“To be able to carry out innovative, socially ambitious programmes (...) and to make sure they stay on track, social businesses need to measure and monitor their practices.”

To be able to carry out innovative, socially ambitious programmes – requiring clarity and transparency – and to make sure they stay on track, social businesses need to measure and monitor their practices. Impact measurement is a complex, time-consuming exercise that may seem like an ordeal to social businesses. Shifting the focus of impact chain analysis from the changes attributed to the organisation to an assessment of its outputs can lead to more effective direct production of information with greater operational relevance. The experience with microfinance suggests that it is a good idea to focus on the management practices of social businesses. By sharing good management and governance practices, identifying tools capable of producing measurements that be used for management and external reporting purposes, and prioritising the combined financial, economic and social efficacy of such approaches to enhance their own solidity and credibility, social businesses have a good chance of saving several years – and averting the kind of “adolescent crisis” that all too many observers are already predicting. When all is said and done, social performance management merely advocates starting at the beginning of the impact chain (social inputs) instead of at the end (the impact on beneficiaries). This feature alone should be viewed as a clear sign of maturity. ■

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2 ▶ To find out more about the OCAT, go to <http://mckinseysociety.com/ocat/what-is-the-ocat/>

3 ▶ The SBS is underpinned by guidelines and feedback from social entrepreneurs who have undertaken a performance assessment and improvement process. It can be downloaded for free at www.cerise-sb.org.

4 ▶ The working group's members are CIDR, GRET, IRAM, AIDR, Entrepreneurs du Monde, AFD, the Grameen Crédit Agricole Microfinance Foundation, Investisseurs & Partenaires and Proparco.

PALMIS ENÈJI: FROM NGO TO ENTERPRISE – THE STORY OF A SOCIAL BUSINESS IN HAITI

In 2012, the French NGO EDM launched a programme to distribute Palmis Enèji cooking and lighting appliances to meet energy demand among the poorest sections of the Haitian population. Two years ago, that social business became a public limited company. This change in status and a partnership with Total Haiti and the microfinance institution PMS has enabled it to expand its activities and will help to underpin its sustainability.



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Haiti, one of the poorest countries in the world¹, has very high levels of energy poverty (72% of households have no electricity). Haitian families use candles and kerosene lanterns for lighting and 95% of households use very basic stoves and wood or charcoal for cooking, thereby exacerbating the problem of deforestation. These cooking arrangements are often inefficient and the fumes cause respiratory diseases.

However, more suitable equipment which is less

damaging to human health and the environment does exist. Solar lanterns provide better quality lighting and are cheaper in the long term. Improved stoves and table-top cookers powered by liquefied petroleum gas (LPG)² use less energy for cooking. But such appliances are hard to obtain in Haiti and very few financial service companies are prepared to finance their purchase. Palmis Enèji was set up – initially as a programme designed and managed by the French NGO Entrepreneurs du Monde (EDM) – to boost their distribution.

CHANGING STATUS FOR SUSTAINABLE ACTION

EDM applies a social entrepreneurship model to support the distribution of appliances that have a very positive impact on health, the economy and the environment among the poorest populations

in developing countries. In Haiti, Entrepreneurs du Monde set about distributing gas-fired table-top cookers and improved wood/charcoal-burning stoves and solar lanterns. The Palmis Enèji project was launched in 2012 as an Entrepreneurs du Monde programme. Because

it was an NGO-sponsored programme, Palmis Enèji was able to take the time to carry out a market survey and test its model (recruit a management and sales team, set up the first franchise outlets, develop a range of products, etc.). It was primarily during this phase that it embarked on social marketing nationwide.

Palmis became independent and was incorporated as a public limited company (Palmis Enèji SA) in late 2014. Although this transition was relatively quick, it took over a year to finalise its corporate governance code, investment methods and transfer shareholder assets. Care had to be taken to preserve the social aspect of the project and uphold the role of EDM's project incubator when the programme assets were being transferred to the company and to smooth the transition from one form and financing model to another.

Palmis Enèji decided to change its legal form at that stage of its development to pave the way for rapid growth in its activities and social impact based on appropriate management rules and adequate financing. In allowing two minority shareholders to invest in its capital³, Palmis was forced to adapt its management procedures to the demands of professional investors. Setting up a board of directors ensured better strategic vision

and sounder risk and financial management.

Palmis Enèji was subsequently able to raise sufficient development resources (capital for starting up franchise outlets and loans to finance growth). The company also adopted a charter setting out its mission statement and commitments that was subsequently signed by all the shareholders and incorporated into the shareholders' agreement and Memorandum and Articles of Association, thereby protecting the company's social mission.

“Setting up a board of directors ensured better strategic vision and sounder risk and financial management.”

Although it had become a company, Palmis Enèji continued to receive grants from international backers in 2015 which were used to finance some of the operating costs of its social mission and to cover operating losses. This hybrid financing method will give the company the necessary resources and time to develop its activities, working closely with its beneficiaries (retailers and end users).

LARGE DISTRIBUTION NETWORK FOR GREATER IMPACT

The company has put together a range of cooking and lighting appliances that meet the most stringent quality standards and enable it to address three poverty factors (BOX P.40). In order to ensure these products reach the poorest sections of

the population, Palmis has set up a network of micro-franchised distributors comprising retailers who already have shops in several towns in Haiti. The micro-franchised retailers are provided with product, social marketing and basic accounting training. →

1 • Out of a population of 10.4 million, 6 million live on less than USD 2.50 a day.

2 • Liquefied petroleum gas (LPG) is a mixture of light hydrocarbons (obtained from oil and natural gas) stored in a liquid state.

3 • Grameen Credit Agricole Microfinance Foundation and Yunus Social Business Foundation.



“The social micro-franchising model was chosen to ensure that Palmis is sustainable in the long term.”

They are also given promotional and marketing tools and supplier credit equal to 90 days' stock so that they can launch this activitins without any start-up working capital. The network is run by franchises which belong to the company and which also warehouse the stock and coordinate marketing campaigns. The last link in this geographical network is the sales force working out of head office which specialises in selling professional cooking equipment to street food vendors. Palmis also has a number of key accounts – local and international associations and Haitian companies working among deprived Haitian communities.

The social micro-franchising model was chosen to ensure that Palmis is sustainable in the long

term and the change in its legal form and structure reflect that choice. Palmis sold 9,600 improved table-top cookers, 1,085 LPG table-top cookers and 9,591 solar lanterns between the launch of the programme and October 2015 (benefitting 100,000 Haitians and 200 street food vendors). Palmis Enèji estimates that it has directly helped to cut CO2 emissions by 36,000 tonnes, to preserve 16,041 tonnes of wood and save 3,200,000 dollars' worth of fuel. Based on its current strategic plan, Palmis should break even in 2018 when the company will have sold over 45,000 lighting and cooking appliances (benefitting over 225,000 Haitians).

Faced with a number of positioning challenges, Palmis has to focus exclusively on its “core business” of establishing a distribution network able to reach the poorest sections of the population. However, it also needs to ensure the network is supplied and to be able to offer its customers credit terms and to publicize its activity and this is why it has adopted a partnership strategy.



PRODUCTS WITH A POSITIVE IMPACT ON HEALTH, THE ECONOMY AND THE ENVIRONMENT

Palmis Enèji's primary objective in promoting more efficient cooking appliances is to halt deforestation. Improved table-top cookers will reduce the volume of charcoal used by households and street food vendors by between 30% and 50% compared to traditional table-top cookers (and LPG table-top cookers will eliminate wood consumption completely). An improved table-top cooker for a family of five translates into a saving of 1.5 tonne of wood a year (LPG table-top cookers save 9 tonnes a year). Improved table-top cookers also reduce the risk of respiratory diseases caused by the fumes generated by traditional appliances and solar lanterns provide better quality lighting. In Haiti, where wood is becoming an increasingly scarce commodity, these savings are crucial: a poor family spends between 30 and 40 dollars a month on cooking fuel. Palmis can therefore help families who buy an improved table-top cooker to save over 10 dollars a month.

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PARTNERSHIP STRATEGY FOR MORE EXTENSIVE ACTION

Palmis opted from the outset to outsource part of its supply process by setting up a partnership with Total Haiti. This Total Group subsidiary imports large quantities of solar lanterns under the group's “Awango” brand name which it distributes through service stations. Palmis buys these lanterns directly from Total, enabling it to negotiate wholesale prices and avoid tying up large sums of money in stocks and it enjoys a two-year warranty on all products purchased. The partnership enables Total Haiti to reach the most deprived people who would not otherwise buy a solar lantern in a service station due to a lack of both information and money. The two distribution networks therefore complement each other.

Palmis is also partnering a microfinance institution to address its customers' inability to save. The company has set up credit facilities in partnership with Palmis Mikwofinans Sosyal (PMS) for its most expensive products (professional table-top cookers and domestic solar kits). Together they developed an energy credit product for PMS customers and prospective Palmis Enèji customers in early 2014. However, demand for the product failed to meet expectations in 2014 and 2015 (its term appears to be too short, monthly instalments too high and the application procedure may discourage some customers). The partners plan to rework the product and application procedure to improve this service. Outsourcing provides Palmis with an existing organization, sufficient liquidity and good risk management, while the PMS network will enable Palmis Enèji to market its products to PMS's 8,000 active borrowers.

Finally, Palmis Enèji is working with several international organizations and backers on national social marketing campaigns in order to publicize its products and actions. By teaming up with other organizations in this sector, Palmis has helped to establish an environment that is conducive to marketing its products without incurring excessive operating costs.

“Palmis is also partnering a microfinance institution to address its customers' inability to save.”

After three years' in business, Palmis Enèji has successfully channelled financially accessible products with a strong social value to the most vulnerable sections of the population. However, as the low profit margins resulting from its distribution model do not yet cover its operating costs, Palmis has “tweaked” its distribution strategy. The first pilot franchise outlet is due to open in a Total Haiti service station so that it can leverage customer footfall while paying only a fraction of the overheads. The sales team based at head office is to be expanded to boost sales via key accounts and the product range is to be expanded to include larger, more efficient solar kits. Coupled with improvements to PMS's energy credit product, Palmis Enèji hopes to increase sales of products with a strong added value while continuing to reach the poorest sections of society. ■

FOCUS ENTREPRENEURS DU MONDE

The mission of Entrepreneurs du Monde (EDM) is to enable thousands of men and women living in poverty to improve their standard of living by supporting their economic initiatives and making it easier for them to access products that will greatly improve their health, the economy and the environment. EDM helps them to succeed and to achieve economic and social progress. The association adopts a three-pronged approach based on social microfinance, social entrepreneurship and the creation of microenterprises.



LESSONS LEARNED FROM THIS ISSUE

FANETTE BARDIN, EDITOR IN CHIEF

Social business is creating new ways of responding to the challenges of economic development. Straddling economic utility and public interest, the concept has attracted a large following in both the developed and the developing worlds. Social enterprises seek to deliver effective, affordable, sustainable solutions to environmental and social issues, while being economically viable. They use the entrepreneurial model to achieve a priority social goal – in most cases that of giving the underprivileged access to otherwise unavailable essential goods and services, such as quality nutrition, drinking water, energy, healthcare, education and financial services. This new approach has caught the attention of a wide range of organisations, including large and small companies, equity investors, NGOs, foundations and international development finance institutions.

compromising quality – through economies of scale, standardisation and new technology – and to adjust the business model to people “at the bottom of the pyramid” – who are often geographically dispersed and relatively unfamiliar with the products on offer, for example. The key to successful social business is meeting the specific needs of target population groups, which means ensuring their involvement right from the design stage, working with local partners and co-constructing appropriate solutions.

The delicate balance between social purpose and profitability ▼

Unfortunately, very few social enterprises reach the critical mass required to secure their profitability year after year and ensure their sustainability in the long term. Many of them also find themselves compelled to make trade-offs if they want to avoid sacrificing their social or financial performance, or the quality or accessibility of services provided. Moreover, the social business sector still accounts for only a fraction of economic output and very few of the companies involved manage to replicate the model on a large scale. The sustainable development of social business – with due respect for its values and hallmarks – will unquestionably be one of the crucial challenges in the years to come. And this fledgling sector will require adequate support to scale up.

Access to funding remains a major hurdle for social businesses, from the start-up phase to the scale-up phase. This immediately brings to mind the situation facing innovative start-up firms, but with the additional handicap of not being able to promise high financial returns any time soon, and of being considered risky – which effectively precludes most conventional sources of financing.

Innovation and co-construction – the keys to successful social business ▼

To be economically viable, a social business must innovate “across the board” – in product design, production technology, distribution methods and marketing. The overriding aim is to cut the cost of producing a good or service without

Impact investing – an opportunity for the social business sector ▼

Social enterprises can alternatively turn to impact investing, an approach to investment that emerged roughly a decade ago with the aim of generating both social impact and financial returns. Impact investing has attracted a growing number of investors with a wide variety of profiles, from pension funds to NGOs. In 2014, it garnered an estimated USD 10.5 billion. The expectations of such investors vary widely, however. Some give primacy to social purpose; others are above all concerned with financial returns. As there are no clear sector boundaries and accepted investment criteria, the actual social and financial results achieved by social enterprises may diverge from investor expectations, and could end up damaging the sector’s credibility. Unrealistic demands for financial pay-off may also lead some enterprises to compromise on social purpose. It is therefore essential to establish guidelines and structure so that the entire range of impact investors can better target their investments. That requires taking a more differentiated approach to investment projects – reflecting the actual weighting of social and financial goals in each one – and setting clear investment criteria, accompanied by precise target ranges for return on investment and explicit social performance indicators. This should make it easier to identify the most demanding business model, the social business, and to support it more efficiently. The credibility of such an approach will further depend on a clear definition of the social business concept – whose outlines are still open for discussion – and the introduction of effective, recognised tools for measuring and monitoring social outcomes.

“Unrealistic demands for financial pay-off may (...) lead some enterprises to compromise on social purpose.”

The need to support social business ▼

In addition to funding, social entrepreneurs need assistance, particularly in the development or scale-up phase. Structures of the business incubator variety can go a long way towards helping the sector get organised and become more professional. More broadly disseminating good practices and business models with a proven track record between sectors, countries and continents is another major challenge. With the know-how they have acquired – above all in the microfinance industry – development finance institutions can assist the social business sector with consolidation by funding innovation, taking part in disseminating good practices, helping to introduce exacting impact measurement standards and so on. Local and national governments can likewise do more to foster social business by providing more effective regulation, supporting the creation of stakeholder coalitions and backing the emergence of local ecosystems conducive to social business development.

▼ Social business is a fabulous test lab for social innovation. Moreover, it offers a promising model for promoting development, provided that the sector manages to consolidate and steer clear of dangers like “social washing”. It is only through common effort – by NGOs, companies, local stakeholders, governments and development agencies – that the many challenges involved in scaling up social business can be successfully tackled. ■

IN OUR NEXT ISSUE ▼

HOW TO EXPAND
CIVIL AVIATION IN
SUB-SAHARAN AFRICA?

Private Sector & Development

Private Sector & Development (PS&D) is a quarterly publication that provides analyses of the mechanisms through which the private sector can support the development of southern countries. Each issue compares the views of experts in different fields, from academia to the private sector, development institutions and civil society. An extension of the magazine, the *PS&D* blog offers a wider forum for discussion on private sector and development issues.

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