

**Extending philanthropy towards social business**

Traditionally, philanthropy has been about gift and donation, the monetary expression of *altruism*, different from purchase and investment/lending which are about satisfying your own needs (buying things) or making money (investing), both of which are fundamentally *egoistic*.

This is being extended to include anything which has an element of altruism or which is *value-led* – pursuing objectives over and above commercial ones. There are not many examples yet in New Zealand but it's growing; there are many examples now overseas.

The “Victorian model”, keeping separate the making of money, on the one hand, from giving it away, on the other, has been the major way in which private philanthropy has been undertaken. Endowed funds are one of the best embodiments of this: their investment returns are focused completely on a commercial objective to maximise return without regard to how the return is generated, while their programme funding is solely focused on donation, to give away the returns.

It's also there in the dichotomy between commerce and business, on the one hand, and charity and NGOs, on the other.

The last 30 years has seen the appearance of intermediary organisations between these two. Some charities have become more like businesses, both as they professionalise their general operations and in creating revenue generating business ventures. Oxfam, for example, is now the biggest retailer by shop numbers on the High Street in the UK. They are becoming biggish business.

Perhaps more radical has been the appearance of social businesses: organisations providing a service on normal commercial terms with the purpose of achieving social and environmental objectives. Fair trade, microcredit, community businesses are all examples. Fair-trade coffee is now about 2% of worldwide coffee sold and growing by about 90% a year (5% is generally reckoned the target to have a major economic effect in improving living conditions for all coffee growers). Social businesses make profits and are profit-seeking but they are “not-only-for-profit”: their fundamental motivations are social and environmental but their way of achieving this is through a business activity.

This collection of organisations and activities is sometimes called the Third Sector, or the social economy, and it's peopled by social entrepreneurs running charities which adopt business methods and businesses which decide to be social. To conventional business they look like charities, but to charities they look like businesses.

**WHEN A LOAN WORKS BETTER THAN A DONATION****THE TREND TO PHILANTHROPIC LENDING**

Within this, philanthropic lending and investment has been a fast growing area. It's triangulated by three main streams of activity

- Microcredit in the developing world – focusing on lending to the very poor – the iconic example here is the Grameen Bank in Bangladesh
- Community investment in the developed world – this is strongest in the US but is present and growing elsewhere – the iconic example is Southshore Bank in Chicago
- Social banking in Europe – with a wide range of investment targets – the iconic example is the trans-European Triodos Bank

All of these, from being marginal activities 30 years ago, are now substantial “movements”. There are several hundred microcredit lenders in the developing world. Grameen is one of the most famous, and its founder, Muhammed Junus, recently receiving the Nobel prize for peace, but there are now many very successful examples. Community investment is well accepted and seen as an essential element of civil society, often now the recipient and disburser of government funds as well as its own funding raised through the normal process of capitalisation and deposit raising. New Zealand has a number of successful exponents in the loan funds which make up Ethical Investment Aotearoa. Social banking which has spread from Europe is now being copied by mainstream banks as they try to “green” themselves. Also slow to appear here, though New Zealand has a representative running successfully and growing steadily over 20 years in Prometheus Finance.

All of this has had an effect on the traditional philanthropic sector internationally, particularly endowed funds. A growing number are

- reviewing whether purely grant-funded initiatives are always the most effective for particular objectives
- broadening the types of entity they will support to include social businesses, including community and social loan funds
- extending the type of programme support they give to include quasi loans and investments
- reviewing investment of their own endowments to align this more closely with their programme objectives – the subject of a separate workshop.

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They are, in effect, beginning to see themselves also as a form of social business. While grant and donation will always be the major part of what endowed funds do, some foundations will diversify into forms of lending and investment. How does/can this work?

**When can lending be a social intervention?**

To give an idea of how this can work, we'll look at four fairly well-established areas

- microcredit in the developing world
- microcredit in the developed world
- social business/enterprise
- pre-funding donations.

*Microcredit in developing world*

- Provision of microloans (and other financial services – savings, insurance, etc) to the very poor in the developing world.
- Grameen Bank is the best-known example but now many others.
- The ultimate client, the micro-borrower, sees a large increase in productivity, and so can pay the true costs of this type of lending. Microcredit is an *economic* intervention with a *social* purpose: overcoming poverty. There's a long history now which shows grants – or “aid” – tends not to work in these instances, removes dignity, creates dependency and stop the development of local economies. Lending works better.
- Microcredit organisations themselves have been on a long quest for sustainability and this is now being achieved. Eg, the ACCION network funded Bancosol, a Bolivian microcredit bank, through Certificates of Deposit issued on the NYSE. However, most microcredit organisations are only partially sustainable and need subsidised credit/capital. Foundations are one source of this, not donating but *investing* albeit at sub-market rates.
- Funding from New Zealand is not so prevalent as it's a very specialised area and generally needs vehicles to channel such investment. An example is the funding of a number of microcredit banks by Triodos Bank and the DOEN Foundation working together from the Netherlands. Triodos is a social bank which has specialised in investment into microcredit organisations in the developing world. It raises funds on a close-to-market basis for such investment. DOEN is a Dutch lottery fund which then underwrites the risk and partially subsidises such investment. The combination creates a sophisticated investment arrangement which provides investment in a form which helps the microcredit banks grow their capital base.

*Microcredit in the developed world*

- This was the subject of the recent report for the Tindall Foundation, looking at microcredit and community loan funds in New Zealand.
- This would probably be best described as “small” credit as loans are larger than the sorts of amounts lent in the developing world (the latter can be as

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low as \$50). Loan sizes can be as small as \$500 but are more typically between \$5,000 and \$10,000.

- The ultimate borrower in these cases will typically be borrowing to set up or strengthen a small business. But the context here is different from the developing world: the increase in productivity is not available. The initiatives funded are usually marginal – “desert flowers” – and cannot pay the true cost of making a loan available. So, this is the opposite of microcredit in the developing world: it is a *social* intervention, often accompanied by considerable support in addition to the loan, which works through an *economic* intervention.
- The microcredit and community loan funds themselves are in a similar situation to the developing world. Below a certain size, they are not sustainable and need continuing subsidy. However, usually other routes open to them (grow, partner, become a quasi bank), and the more successful achieve this. They may still require subsidy for their client programmes, but then not for themselves – the reverse of the case in the developing world. This was one of the main focuses of the Tindall report.
- This is a combined social and economic task and often there is a trade off between generating an economic return and a *social return*. In general, perpetual subsidy of such funds is not a fruitful way forward (it will never end): funding is better where it helps capitalise them so they can grow to become sustainable.

*Social business/enterprise*

- Already described in outline. These are intermediary organisations which generate social value and can earn an income. Microcredit and community loan funds are themselves examples. Other examples
  - local community facilities like a tennis club which can charge modest fees
  - social housing
  - educational initiatives
  - community businesses
- Lending in these cases will almost certainly be on “sub-market” terms – lower interest rates, absence of adequate security. If it is not, why is the initiative not getting the money from a bank?
- A basic test of whether lending rather than a grant might be used is that the income is reasonable and not forced. Forcing will destroy the “social return”.
- Lending in such cases has two main benefits
  - It recycles programme funds so they can be used again multiplying the social benefit.
  - A loan creates “tension” in the project which, well handled, *strengthens* it improving its financial management and requiring it to look more closely at the services it is providing to see where they create value. This may seem counter-intuitive but there’s a lot of evidence that this really is the case. For example, a local community will tend to undervalue what is free over what they would be happy to pay for, albeit at a modest level.

**WHEN A LOAN WORKS BETTER THAN A DONATION****THE TREND TO PHILANTHROPIC LENDING***Pre-funding donations*

- It's quite common for a capital project to need two rounds of fundraising: firstly, when the project is still at a conceptual stage which draws in those more committed; secondly, when the project is underway and either partially complete or being built, when donors needing something more concrete will donate.
- For the project to get underway, it's then best to raise initial donations and a specialised loan. This ensures full funding is in place and the project can proceed. The loan will then be in two or three stages: (i) short-term to be repaid from subsequent fundraising; (ii) flipping over to a longer-term loan for any shortfall on the fundraising where there is an income stream which can support it; or (iii) where there is no income stream, becoming a donation to cover the shortfall.
- Borrowing communities. These are a structured form of fundraising where the donors do not have capital but are prepared to commit to providing funding over say 4 years from their income. A loan then allows the project to proceed and is repaid by the borrowing community. These are widely used in Europe. Prometheus Finance has been using them successfully here for some years.

**How to lend?**

- Making grants and lending are quite different sorts of activity despite many superficial similarities. So, if you want to consider lending, it's important to be clear what's needed else you will tend simply to make bad loans, and that helps no one.
- Grants are usually a one-time transaction paid over and the relationship is then "complete". There may be a requirement one project to report back, and there may be further grants which are sought in the future, but typically they happen once and that's it.
- Loans create a relationship over time with more complex obligations on both sides.
- They need special-purpose agreements which are rigorous without being overly complex and are prepared in advance. Ad hoc lending is very risky!
- The lender needs a basic infrastructure to manage the lending. This requires administration upfront and, most importantly, the ability to monitor repayments. The most effective way to avoid bad debts is to contact the borrower the *day* a payment is missed. This needs to be as tight as a high street bank even though how you deal with missed payments needs to be more understanding than the banks tend to be.
- Lastly, it needs to be clear that a loan really is a loan. The difficulty for a grant-giver making loans is that borrowers tend not to believe that the loan must be repaid. This has bedevilled the work of some major NGOs in trying to establish microcredit programmes in the developing world. Shakiness in the belief that a loan is really a loan, within both the lender and the borrower, can be a major stumbling block.

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- Lending could be subcontracted. Partnerships with a community loan fund could be the way to go.

**Mixing endowed and programme funds**

- An interesting development amongst some endowed funds has been making loans through mixing endowed and programme funds.
- In essence, the fund applies some of its endowed funds to provide the loan but it maintains the requirement to earn a commercial return on these funds. It achieves this by subsidising the lending using its programme funds and so softening the term to something appropriate to the needs of the borrower.
- In this way, the borrower's social return is recognised through the implicit grant, and the endowed funds own investment funds are applied in a way more closely aligned to their social objectives.
- This is a good example of the type of flexibility which philanthropic lending can undertake – generally much more so than a bank could ever achieve.

**In conclusion**

- Why lend?
- In the appropriate circumstances, it's actually better for the project and the objective of the funding.
- It extends programme funds, sometimes considerably, by letting them be recycled.
- Philanthropic lending can be far more flexible in its approach than commercial lenders.
- It responds better to the needs of intermediary organisations, social and charitable businesses. These are more prevalent elsewhere but they are growing here, starting to create a social economy.

Glen Saunders

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