THE ARCHITECTURE OF SOCIAL FINANCE

Chapter · January 2017

1 author:

Gadaf Rexhepi
South East European University

THE ARCHITECTURE OF SOCIAL FINANCE

Dr. Gadaf Rexhepi[1]

[1] South East European University, Macedonia

Abstract

Social finance recently had started to show great results and prove to best eliminate the effects of last financial and economic crises. In this text it is represented the role of social finance that it has in the economy and is proposed as one of the ways how poverty, unemployment, inequality can be reduced. Social finance proposes a better way of dealing with poverty than philanthropy or a welfare state model. Social finance influence the social change inside one economy motivating people to give up from profit maximization and orient them toward profit that will be earned while taking care of social and environmental needs. Social finance tend to create organization that will be self-financed and not depended on the government grant or charities. This organizations in the future will increase the number of employees and they won't be needing government grants or charities for them to operate successfully. Part of this chapter is the influence of social finance in social change which influence the organizational design of enterprises and change in the government legislation. Also we analyze the process how social finance works and the main form of social finance emphasizing to the SIB as main form which allows share of risk between two parties.

Introduction

Research showed that while giving is increasing, the number of donors is actually dropping (Strandberg, 2006). Charity organization are financed mainly by governments (about 80%) and in a small portion from other sources like grants, sponsorship, donation etc. This is the case of many most important charity organization among which one of the oldest charity organization, the Benevolent Society, with more than $80 million income per annum, out of which 82% are money given from government (Tama and Sato, 2012, p.13). But what if governments due to many reason fail to deliver this grants to charity organization. Will they continue to exist? What will happen with those who are in a need then? Social Finance as a concept propose a different way of dealing with the poverty.

Bill and Melinda Gates are among the most known philanthropist in the world, just in 2012 they gave away 3.4 billions of dollars. According to their declaration they will continue to do so and give away a big portion of their wealth in the next year. Considering that their fortune in the moment is about 77 billion dollars and still growing, this will be a huge amount of money. Warren Buffet also started to give away huge amounts of dollars, he has pledged to give away 99% of his wealth. Also there are lot of other billionaires, rich people, government organization that are helping others. This is great, but will this solve the problem of poverty all around the world? Let me raise a hypothetical question if all billionaires decide to give away 80% their money for charities will this solve the problem of world poverty? This money will be given mainly to charity organization who will then deliver to those in need by solving the problem for some people for some years. But will it be possible to solve the problem with world poverty forever? Unfortunately this won't be enough, mainly because of the way how these money are spent.

A great way of dealing with this problem comes from *social finance,* which is designed to help economies where everybody will benefit. Social Finance today has raised a huge interest, it become a very often discussed topic in conferences, seminars, research journals, universities, government's, municipalities, publishers etc. Studies showed that after the last financial and economic crisis lot of financial organization are making pressure to corporate executives, to provide financial reports for their nonfinancial performance (Cho et al, 2012, p.54). Which means that organization should take care of their employee's motivation which is one of the main goal of social finance to make a balance between organizational profits (moderate) and employee motivation. According to a survey done by JP Morgan and the Global Impact Investing Network (GIIN) in November 2010 this market was estimated from $183 billion to $667 billion, and invested capital in the range of $400 billion to nearly $1 trillion (O'Donohoe, Leijonhufvud & Saltuk, 2010). In May 2009, U.S. President Barack Obama created a $50-million Social Innovation Fund and a new White House Office that will coordinate the fund's efforts (Mair and Ganly, 2010. p.103). The amount invested by the 125 leading impact investors in social finance is forecast to grow by nearly 20% this year, according to the latest study by the Global Impact Investment Network and JP Morgan (Wilson, 2014). Recently several G8 countries, most notably the United Kingdom and the United States, have been active in creating new social investment models while interest and activity is emerging in other countries as well. These initiatives, led by governments, foundations, investors and other stakeholders, have helped accelerate the market in the past few years (Wilson, 2014, p.4).

The article published by Michael Porter and Mark Kramer, the famous Harvard Business School professors, "The Big Idea: Creating Shared Value" (2011) argue that corporate strategies must be adapted to service social needs. Traditional thinking was that pursuing social or environmental objectives could require some financial trade-off,

although necessarily a financial loss. As experience in the market developed, a growing number of examples demonstrated that, in certain areas, social investments can generate both a solid financial and social return. It is in these areas that social investors can play a role in providing private capital to address social challenges in innovative new ways (Wilson, 2014, p.4).

But social finance is still a new concept and not everybody is familiar with this concept. Research showed that social finance as a concept tend to be more familiar to people working in the niche financial sectors, such as socially responsible investing and credit unions (Hariji et al, 2012, p.11). This chapter is an attempt to clarify the concept of social finance and its architecture by defining it, explaining the model of social finance (how it works), state the types of social finance and point to the positive side of social finance for the society in the future.

What is social finance?

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

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

- Impact investment - investing for both a financial return and a social return
- Social banking – investing deposits in social enterprises
- Charitable banking - banking with a specific focus on the needs of charities
- Providing banking services and advice to financially excluded individuals,
- Crowdfunding platforms for funding social ventures

There are many definitions about what is social finance, unfortunately there is no broadly acceptable definition about *what social finance is and what it incorporates*. Lack of clarity around the definition and scope of social finance influenced to the perception of investments in this area as being high-risk. The perception is that non-profit organizations rely heavily on grants, which means that these organizations aren't interested in managing them toward it's grow and profitability (Hariji et al, 2012, p.14).

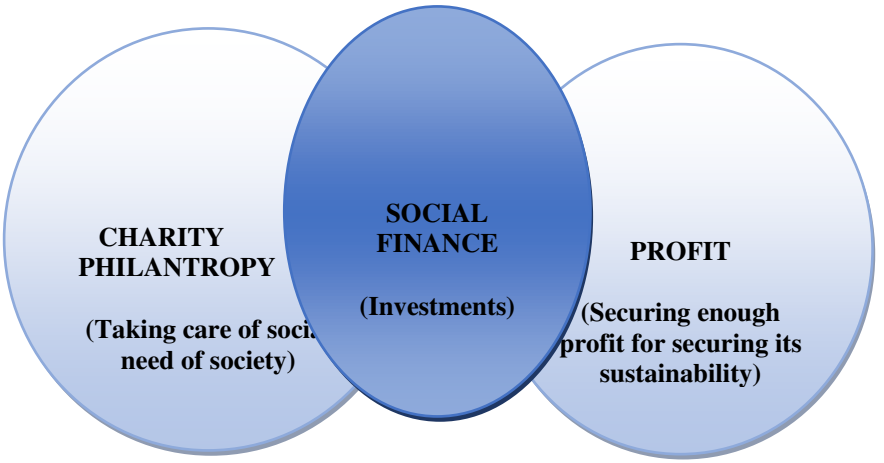


Figure 1. The role of Social Finance (source: author)

Social Finance is oriented toward investments through which tries to generate financial return to secure organization sustainability, through solving social or environmental challenges. Investments are generated from private investors and governments which through social finance generate profit and bring public good for everybody. If we analyze many definitions we will see that social finance sits between charity/philanthropy and profit. Social finance tries to ensure that the organization is gaining profit so that it can secure its own existence in the future, and that by doing so it is taking care of social and environmental needs (Figure 1). Organizations that are social shouldn't depend from charities, they can be as initial form of financing or they can help the business development but it shouldn't be its only form of financing (Cetina and Preda, 2013, p.10).

Social finance is the deliberate, intentional application of tools, instruments, and strategies to enable capital to achieve a social, environmental, and financial return (Harji & Hebb 2009). Organizations that receive such investment can be found in the non-profit and for-profit sectors or in the hybrid space between them. Some suggest that social finance pursue is a triple bottom line, whose goal is to deliver *social, environmental and economic benefits* (people, planet, profit) (Hariji et al, 2012, p.6). David Hutchison, chief executive of social investment intermediary Social Finance Ltd, says he defines "social finance as investing capital to create social change" (Howard, 2012, p.12). Even though that there are differences among different researcher about what social finance represents, still we can find one thing in common: *the innovative use and combination of resources to pursue opportunities to catalyze social change* (Mair and Ganly, 2010, p.103). Which means that the use of social finance will lead to social change which will lead to the change of the social behavior and social relationship of institutions and people. Social change programs have been made also

through social policy and taxation as well as in many other ways in some countries like Holland, Norway, Canada etc. This leads to the increase of citizen's standards and reduce the inequality in this countries. Howard (2012, p.3) stated that on a spectrum of investment types social finance deals with *philanthropy and socially responsible investing*. Philanthropy because these organization don't seek for profit maximization and they distribute their main profit to its employees and investors (usually citizens). Socially responsible investing, because these organisation tend to not maximize their profit which means selling of cheap qualitative product, they usually hire people in need like homeless, disabled and others. Usually they deal with a problem that is for the good of society and they always take care of the environment.

To warrant the title "social" surely being a little bit social or social at the margin can't be enough to warrant a totally new asset class? This probably requires distinction to be made between those investors who put capital entirely at risk in a quest to find new solutions to meeting social needs and those who are providing low-risk capital at only just below market rates whilst also achieving some degree of social impact. Social investor differ from grant funder, s*ocial investment is the provision and use of capital to generate social as well as financial returns. There are some new and emerging sources of social finance, th*e following sources of social finance were identified (Strandberg, 2006, p.5):

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

Figure 2. Overview of social finance marketplace

Source: Adopted according to Mayers and Conte, 2013

In Figure 2, we can see an overview of social finance and the way how this market operates. There are three sides of this market places the demand side comprised from actors who need social finance, the supply side where we have the actors who provide social finance and intermediators that connect social actors who need additional capital with private actors who can supply capital. Note that governments can be actors on both the supply and demand side of the social finance marketplace (Mayers and Conte, 2013, p.9). This model also explains the way how social finance works. Intermediators here appear as institutions that help the investors to invest their money in the demand side for social purpose.

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

1. **First,** social finance approaches should not be seen as a substitute for government funding but rather as a complement.

2. **Second,** social finance approaches should not be seen as synonymous with privatization of social services. Even though that there are differences in defining social finance still it is generally accepted that social enterprises must have a social mission at the core of their operations.

3. **Third,** from a more tactical standpoint, social finance approaches are not simple to mount. The process of building a social enterprise is similar to starting any kind of enterprise and having a social mission is no guarantee of success.

One of the dilemmas that appeared among many institution like governments, organizations, researchers, and other relevant parties is if there are differences between social finance and CSR and not-for-profit charity work (Kerlinger and Lee, 1999). The answer is definitely yes, social finance is conceptually very different approach to social welfare enhancement. It uses some concept of neoliberal markets and it is increasing the need for social and environmental improvements on the other side, with a huge potential

to make a tremendously positive impact in the economy (Massetti, 2011*, p.61).* Another difference of social finance and charities and non-profit organization is that social finance secures its own sustainability by being profitable. This means that social finance isn't necessary created by government or donation but also with own funds, borrowing, taking micro loan etc.

Another dilemma is the relationship of Micro finance and social finance and is there a difference? Micro finance is as a form of financing that also tries to deal with poverty. The pioneer of microfinance is the Muhammad Yunus, who established the Grameen Bank that deliver microcredit loans as of October 2011 (Hariji et al, 2012, p.6. Micro finance gets its attention much more after the Nobel Prize was given to Muhammad Yunus in 2006 and also because it was the only asset class that generated a positive financial return during the last financial and economic crisis. According to Muhammad Yunus (1999) microfinance is the best way in fighting world poverty in the developing countries. But microfinance as originally proposed by its creator is very hard to find, many banks and organization as Mohamed Yunus stated in his last interview in 2015 "The idea of micro-credit has spread across many countries. But, there have been certain pain points. People are missing the concept of micro-credit. They are using it to make money for themselves, rather than using it as an opportunity to help people to come out of poverty. That is not micro-credit". This mainly because of the existing laws that allow the creation of banks for the rich. You need a banking law to create a bank for the poor, stated Yunus (Business Today, April 12, 2015). In May 2011 one of the most influential organizations in micro financing Kiva had distributed 213,942,425 dollars in loans to 554,116 entrepreneurs through 285,142 loans. Surprisingly the repayment rate has been 98.8% (Galak et al, 2011, p.130). Even though both of the methods try to help those who are less fortune in the society but the difference is that microfinance is form of crediting and social finance is a form of investment.

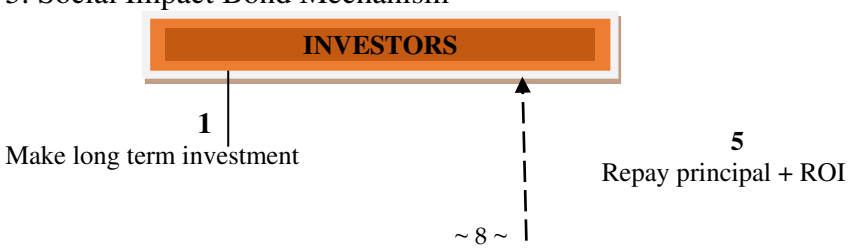
Forms of social finance

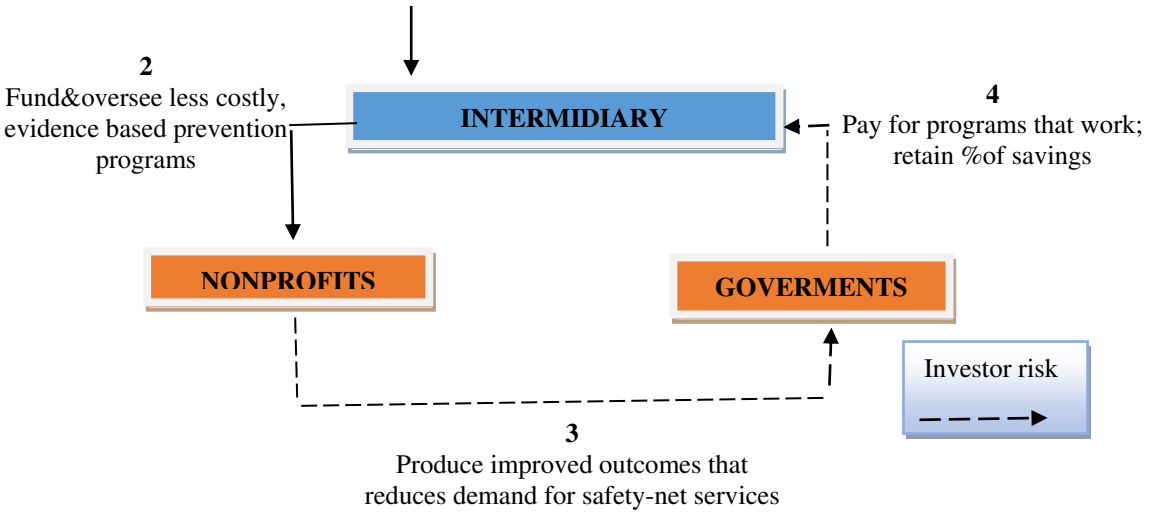
In the literature and practice there are some forms of social finance through which the process is realized:

1. **Social impact bonds (SIB),** It is important to state up front that an impact bond is not a "bond" in the sense of a traditional, fixed-rate-and-term security such as a municipal bond, but is better understood as a rigorous outcomes based contract between multiple parties (Shah and Costa, 2015, p.5). **A social impact bond is** an instrument for funding projects where a prearranged amount of money is paid out if performance results are achieved. SIBs combine a pay-for-performance element with an investment-based approach: private investors provide up-front capital to fund interventions, and can expect to get back their principal investments and a financial return if the results are achieved (Harnessing the PSF,

2013). Social Impact Bonds (SIBs) Aligning the interests of nonprofit service providers, private investors, and governments, SIBs raise private investment capital to fund prevention and early intervention programs that reduce the need for expensive crisis responses and safety-net services (Finance, 2012). Unlike standard bonds, is not a form of debt security in which interest is paid by the issuer of the bond to the holder at maturity? SIBs combine a pay-for-performance element with an investment-based approach: the investor invests its capital but its principal and interest will be paid only if this investment had been successful (Harnessing the PSF, 2013, p.22). In this form the capital owner is actually sharing the risk with the borrower (company that gets the capital). The impact bond concept originated in the United Kingdom, where the first social impact bond, was launched in 2010. In 2012 it had about £600 million in available capital raised largely from unclaimed assets in British financial institutions (Shah and Costa, 2015, p.6). _Social Impact Bonds align the interests of nonprofit service providers (Finance 2012). New York City established the first SIB in the United States. The initiative provides services to 16- to 18-year-olds who are jailed at Rikers Island and aims to reduce recidivism and its related budgetary and social costs. Services are being delivered to approximately 3,000 adolescent men per year from September 2012 to August 2015. Recently, the Harvard Kennedy School SIB Lab requested applications for additional US jurisdictions to assist. Twenty-eight state and local governments applied. Why are so many governments interested in SIBs? SIBs offer an answer to a question all policy makers are facing in these difficult fiscal times: How do we keep innovating and investing in promising new solutions when we can't even afford to pay for everything we are currently doing? SIBs also align well with the spread of data-driven leadership practices focused on improving government performance and with government efforts to (Azamati et. Al, 2014) Also many countries as Australia, Canada, Columbia, India, Ireland, and Israel have started exploring SIBs. Proposed projects target social problems ranging from recidivism to homelessness, unemployment, youth outcomes, and early childhood education (Azamati et. Al, 2014).Social impact bonds should not be used in instances where cessation of services would result in harm to a population or used to finance critical public services such as primary and secondary education (Shah and Costa, 2015, p.9).

Figure 5. Social Impact Bond Mechanism





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

Adapted from Jeffrey B. Liebman, "Social Impact Bonds," Center for American Progress (February 2011). (Social Finance, 2012)

In figure 5 we can see the way how Social Impact Bond operates in practice. But despite the evolution of the market and positive side mention, several challenges remain. These include a lack of products and capital across the full risk/return spectrum, a shortage of intermediaries and a scarcity of high quality investment opportunities into which larger amounts of capital can be deployed. Transaction

costs in social investment remain high due to fragmented demand and supply and the complexity of deal structuring. As in the mainstream financial markets, there are information asymmetries between investors and investees. These asymmetries are further compounded by the lack of commonly accepted standards for measuring social investment, confusion of terminology and lack of information about both existing investment provision as well as related government policy. There is also imperfect competition in the market due to high transaction costs as well as the lack of brokers, advisors, exchanges and other market mechanisms (Wilson, 2014).

2. **Social investment funds** (SIFs) pool capital from investors to provide loans, mortgages and venture capital to NFPs, social enterprises and social purpose businesses with longer payments allowing organizations to access "patient working capital" (funding with a longer-term repayment schedule) as well as bridge loans.. The Social Innovation Fund invites applications from external organizations sometimes called intermediaries with strong track records of finding and funding effective social service organizations. Through a competitive process, the Social Innovation Fund makes grants from $1 million to $10 million per year for up to five years to these intermediary organizations (Shah and Costa, 2015, p.2). These federal grants then leverage private and philanthropic dollars twice: first, the intermediaries must match the federal grant they receive dollar for dollar with nonfederal sources; then, the grantees who receive funds from the intermediaries must likewise match that award 1-to-1 with other donations. This funding arrangement means that the $137.7 million awarded by the Social Innovation Fund since 2010 has leveraged $350 million in commitments from nonfederal sources (Shah and Costa, 2015, p.3).
3. **Development impact bonds:** this type of bonds take the social impact bond model and apply it to another area that has seen a growing emphasis on measurement, evidence, and striving for improved outcomes: international development (Shah and Costa, 2015, p.10). DIBs are a financial instrument that can bridge the gap between investors and opportunities, and between financial returns and social benefits. For both social and development impact bonds, issues around risk and risk-sharing promise to be problematic. Development Impact Bonds are a new approach and projects cannot be easily put together using the existing procurement systems of most public sector agencies. Essentially, DIBs are about forming partnerships, and to adopt this new approach donor agencies should work closely with recipient country governments, potential investors, intermediaries and service providers. This collaboration will help ensure that DIB contracts developed are attractive to investors, create the right incentives for service providers and offer good value to outcome funders, and so establish a good starting point for future deals. To

reduce transaction costs and help build an evidence base for DIBs, pilots should be developed, implemented and evaluated in a transparent and "open source" way. Donor agencies can drive transparency in DIB transactions by requiring that outcomes data be made public, and contracts also be published. As a results-based approach, DIBs are meant to improve information about the impact of donor funding. This is only possible if information about how funding is being used and the results of program are publicly known (Social Finance, 2012). Notably, one of the attractions of the impact bond model for governments is that it transfers away the risk that public dollars will be spent on ineffective programs; however, until the true risks of the model are better known and more predictable, many private investors are likely to balk at the all-or-nothing nature of financial returns inherent to the model (Shah and Costa, 2015, p.12).

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

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

6. **Program delivery scaling/leveraging:** A number of submitters to the Call for Concepts recognized the potential of social finance to augment existing programs by providing funds to increase the delivery area, widen the service offering or add a needed new element to the program (Harnessing the PSF, 2013, p.25). Although these concepts did not all delve deeply into how the financing partnerships might be structured, each provided evidence of the effectiveness of the foundational idea – as in the YMCA Canada's concept to create a national, single-window solution to support youth employment through

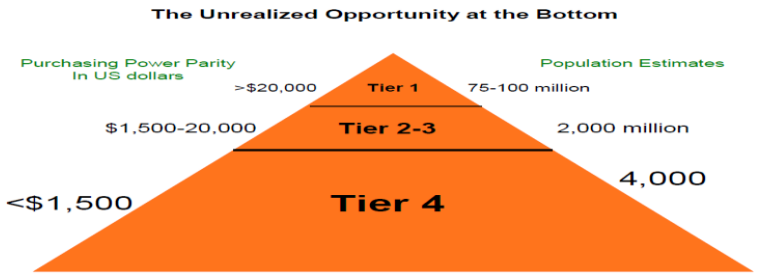
> an internship framework. This concept suggests that the multitude of youth employment attachment programs offered across Canada results in a complex and redundant web of resources for youths seeking work, service providers and employers. Accordingly, the YMCA suggests extending its existing, successful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

If we analyze all forms of social finance we can conclude that social impact bond has been the most used and most developed forms of social finance. The main benefit of this form is the risk sharing meaning that the organization taking the money will repay this money (principal +interest) only if it is a successful project. Definitely this is great for the organization receiving the money but is this the best way to give the money having in mind that the point of social finance is to secure sustainability of project. We need to think will this money be spent wisely as if the owners would know that if they are not successful they don't have to pay anything. Maybe postponing the payment for some year will be the solution. This problem is solved also with pay for performance when organization will take the money only if they achieved a result pointed out by the government previously. The positive side of social investment fund is that the organization don't need to pay interest and they return the same amount of money but they need to do this in the period of five years which sometime might be very hard for the organization having in mind that they are not for profit maximization and to have a ROI of five year is quite a challenge. The main positive side of DIB is that it uses the money in more effective way than the government but the problem here is very similar with SIB because it enters as partner in risk sharing. Sector capacity-building organization are very helpful for organization by teaching them on how to use the social finance, but there are many problems like how qualified are these organization, who is going to select them etc. Program delivery scaling/leveraging as its main positive side it has that it opens a window of opportunity for young people by delivering them experience.

The importance of social finance in making the social change?

Social finance has different organizational intent which is oriented toward using the power of the marketplace to solve social and environmental problems (Massetti, 2011, p.50). Authors C.K. Prahalad and S.L. Hart in 2002 published a paper "The fortune at the Bottom of the Pyramid" which was discussing about the largest but poorest socio-economic group of people. According to the research from all six billion people in 2002 in the world four billion of them are in the group people with low income living with less than 2 dollars in a day where many even with 60-70 cents in a day. The percentage of poor is still very similar. Can this group of people enjoy the life as the middle and upper class? In the past three decades the prices of almost every product increased very much. For the four tires of people it will be impossible to ever have the chance on having the same life as first tire group. The main problem is that these groups of people aren't getting rich with the same speed as the price of almost everything and this means that the inequality will be even higher in the future.

Figure 3: Base of the Pyramided



Source: Prahalad and Hart, 2002, p, 4

Even though in the world every year is spent more than two trillion dollars from the government of the developed countries still they failed in increasing the living standards of these people. Go to the website of almost any corporation and you can read about its commitment to the environment, to fighting poverty, to education, to health, or to the arts. None of this is true *(Rippey and Subhash, 2013, p.7).* This mainly because as Milton Friedman in his famous book Capitalism and Freedom, published in 1962 noted that *"There is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition, without deception or fraud . . . . "(*Rivilin, 1983, p.153). Social trends are only getting worse, the situation with number of charities is getting smaller every day and the number of people in need is increasing especially with population aging, unfunded pension

liabilities and pressures on the tax system (Strandberg, 2006). The world population is growing rapidly in the last century moving from 1.6 billion in 1900 of people into more than seven billions of people in 2015 and according to prediction more the ten billion in 2050. Rapid growth of the world population resulted in rapid ageing of the population which will cause problems for young people to secure retirement income. Result showed that in 2011 about 17.66% of the Finnish population is aged 65 years or above, having in mind that life expectancy of the Finnish population is around 79.41 it will be very hard for the economy to handle this (Social Landscape, 2012, p. 51). These and other problems like unemployment, inequality and similar will require devoting a higher share of society's output to social protection which need to be shared in varying degrees between the public and private sector (*Asher and Azad, 2014*, p.68).

Just as Schumpeter explains that during the period of crises there will be an innovation rising. This was the case in almost all economic and financial crises ((*Policy Review, 2012*, p. 92). Social finance and its influence on social innovation and social entrepreneurship are this innovation, which proposes a better model in solving the problem especially with the four tire by creating enterprises which won't be motivated to create extra profit but reasonable profit. This means that these corporations will sell cheaper and qualitative products. Also social finance will hire employees that belong to different social groups by which it will influence their quality of life. The main benefit here will be that it creates an organization that will be sustainable and the government won't need to give them charity every year, these people are employed. Than this money can be spend on other social problems of society or create other social finance institution to help others. By charity the governments need to sponsor these group of people every year and don't use their potential. Social finance won't substitute the actual system but it is just offering solution to some actual problems by making the social change.

Thus Ashoka one of the leading organizations in social finance is promoting the concept of "Full Economic Citizenship" for civil society organizations and are engaging the corporate sector, particularly financial institutions, and policy makers on developing the tools and programs to scale up civil society organizations to meet the challenges of the century (Strandberg, 2006, p.4). Rather than striving only to externally regulate the institutions of profit maximization, we must move to redesign them at their core (Kelly, 2012)). Making the shift, over time, from the dominant extractive designs of today to generative designs will take a combination of private innovation and government guidance (Kelly, 2012, p.6) In trying to imagine a large-scale shift in the social architecture of the economy, it may help to recall a prediction made a half-century ago by Robert Heilbroner: "Capitalism will inevitably change and in the longer run will gradually give way to a very different kind of social order" (Kelly, 2012, p.7). Social finance approaches helps governments improve outcomes by aligning interests so that capital is channeled toward the most effective interventions. The potential of social

finance to create incentives for increased alignment may be the most significant benefit that social finance approaches can bring (Myers and Conte, 2013, p.6). Kelly (2012) argues that multiplication of these models represent a largely unseen ownership sea-change rising across the globe. At its heart is a genuinely different ownership archetype. Instead of being about maximizing financial gains, these ownership designs are about serving the community, often being financially self-sustaining and the many of these institutions are profit making. But they are not profit maximizing. They represent a new category of private ownership for the common good. Taken as a whole, these ownership designs could create the foundation of a new kind of economy, a generative economy, where economic activity again serves its original purpose of meeting human needs. Social finance influences the middle class, because on one side it creates cheap product and also if the enterprise become successful it will create gain for more people.

The relationship of social entrepreneurship, social entrepreneur's, social innovation and social finance

Social finance actually represents the emergence of new models. These include social enterprises, which serve a primary social mission while they function as businesses, these new enterprises concentrate on serving many stakeholders, not just stockholders (Kelly, 2012, p.3). Social finance then stimulates social innovation which influences the appearance of Social Entrepreneurship and further to social entrepreneurs. The notion called *Social Entrepreneurship* (SE) has emerged in late 1990s in US and UK and it has become a global phenomenon, seen as innovative approaches to solve social problems and at the same time creating economic value. SE use their creative talent to develop solutions to social problems that range from cleaning up the environment to improving working conditions for workers around the world; their aim is to use their businesses to make money *and* to make the world a better place to live. SE in practice embrace a wide mixture of activities such as: creative individuals devoted to making a difference; social purpose business ventures dedicated to adding for-profit motivations to the nonprofit sector; new types of philanthropists supporting venture capital-like 'investment' portfolios; and nonprofit organizations that are reinventing themselves by drawing on lessons learned from the business world (Mair, Robinson and Hockerts, 2006). Jeffrey Robinson defines social entrepreneurship "…as a process that includes: the identification of a specific social problem and a specific solution… (Social Entepreneurship, 2006). Social entrepreneurship is related with the social entrepreneurs. According to Francesco Perrini and Clodia Vurro '…*social entrepreneurs* are change promoters in society; they pioneer innovation within the social sector through the entrepreneurial quality of a breaking idea, their capacity building aptitude, and their ability to concretely demonstrate the quality of the idea and

to measure social impacts (Social Entepreneurship, 2006). The origin of the phrase "social entrepreneur" can be traced to Bill Drayton, a former business management consultant who in 1980 set up Ashoka, the first foundation to support and fund such individuals. Today Ashoka has over 2,000 "fellows" in more than 60 countries and continues to expand (Mair and Ganly, 2010, p.104).

Figure 4. The influence of social finance (source: author)

Social entrepreneurs than need to create social innovation which will lead to social enterprise. Social finance is depended on social innovation at the same level as social innovation is depended from social finance. Recently, the European Commission published paper titled the "Guide to Social Innovation" talking about the benefits of innovation and how it can play out to offer societal solutions (Myers and Conte, 2013, p.6). The results of social innovation are all around us. Self-help health groups and self-build housing; telephone help lines and telephone fundraising; neighborhoods nurseries and neighborhood wardens; Wikipedia and the Open University; complementary medicine, holistic health and hospices; microcredit and consumer cooperatives; charity shops and the fair trade movement; zero carbon housing schemes and community wind farms; restorative justice and community courts. All are examples of social innovation – new ideas that work to meet pressing unmet needs and improve peoples' lives (Mulgan, 2010, p.7). Social innovation refers to new ideas that work in meeting social goals (Mulgan, 2010, p.8).

As we can see from the figure 1 Social Finance is a cycle that influence social innovation, which influences social entrepreneurs, that influence creation of social organization and in the end it will result in social entrepreneurship. If we analyze the

figure 1 from the opposite side we will understand that also social entrepreneurship, social organization, social entrepreneurs and social innovation also influence its existence. Which means than social finance influence social innovation but it is also influenced by it.

Role of government in social finance

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

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

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

Conclusion:

Many governments try to deal with poverty by different means like social policy, taxation, social work, social welfare or charity. In this way of operating poverty continues to be present because we just solve their problem for very short time. This is not the solution. One of the best solutions to this problem comes from *social finance,* which is designed to help economies where everybody will benefit. Social finance will influence in the decrease of the unemployment rate, it will influence the reduction of disparities on the long run, it will lower the poverty, it will influence taking care of the environment, it will orient our energy toward social innovation etc. Social finance has a three main postulates, it tries to achieve a social, environmental, and financial return. Social finance is conceptually very different approach to social welfare enhancement. It uses some concept of neoliberal markets and it is increasing the need for social and environmental improvements on the other side. It struggles to find a way for this people to stand in their own legs, because this organization will work profitably. Social Finance takes care of sustainability of enterprises, these enterprises are self-financed. Social finance isn't necessary created by governments or donation but also by private investors, different organization, own funds, borrowing, taking micro loan etc.

Social finance is a savior to the actual economic problem which it started to show huge defects, this was obvious with the last financial and economic crises. Should a great economic system show these problems and this very high level of inequality? Social finance doesn't require new economic system but uses the actual economic neoliberal system. It tries to solve some of the problems and especially change the logic of Milton Friedman about what is social responsibility. It makes the shift of the wealth from the hands of very small reach owners to a huge group of people, who will earn a reasonable profit. Because social enterprises are not own only by one person but by many investing very small amounts of money or other assets who usually are also employed, sometime they can be even 100% employee owned. With social finance many people will be earning good amount of money instead of just a small group of people getting very rich. Social finance on the other side will lower the prices of products and services since organization won't charge huge prices because all of them require reasonable profits. Social finance will lower the inequality because there will not be extremely rich people who with their huge purchase power can increase the price of things (prices of apartments in Manhattan) but these prices will grow very slowly as the standard of people is growing. Many people will be employed and the percentage of firing employees will drop down very much. Social finance also influences social innovation and social entrepreneurship which can solve many problems of today's economic system. Social finance approaches enable governments to *share the risks* with

the private sector. Social finance approaches helps governments improve outcomes by aligning interests so that capital is channeled toward the most effective interventions. Social finance creates fundamentally different kind of organization, on the mission of the organization and different ownership. This organization will influence the existing architecture and create a different kind of economy in many elements. Social finance actually represents the emergence of new models. These include social enterprises, which are oriented mainly toward solving some social problem but also trying to gain a reasonable profit. This kind of enterprises are starting to be established all around the globe, established by many people who really care about the social effect and want to earn a reasonable profit.

List of references

1. Coro Strandberg. 2006."*Exploring New Sources of Investment for Social Transformation" Simon Fraser Harbour Centre*, Vancouver BC.
2. Karen Myers and Natalie Conte. 2013. **"**Can social finance improve the outcomes of employment and training programs?" Social Research and Demonstration Corporation.
3. Johanna Mair and Kate Ganly. 2010." Social Entrepreneurs: Innovating Toward Sustainability" y, WORLDWATCH INSTITUTE.
4. Ellie Howard. 2012. " Challenges and opportunities in social finance in the UK" CICERO.
5. Mukul G. Asher and Azad S. Bali.2014. "Financing Social Protection in Developing Asia" *Journal of Southeast Asian Economies* 31 (1): 68-86
6. POLICY REVIEW. 2012. "The Ongoing Transformation of Social Housing Finance in France: Towards a Self-financing System?" *International Journal of Housing Policy* 12 (1):91–103.
7. Brenda Massetti. 2011.""The Duality of Social Enterprise: A Framework for Social Action, *Review of Business*, St. John's University, p: 50- 64.
8. Seong Cho, Cheol Lee, and Cheong K. Park. 2012."Measuring Corporate Social Responsibility" *THE CPA JOURNAL*, p: 54-60.
9. Social Landscape. 2012. "Market Line" PESTLE Country Analysis Report: Finland, p. 51-55.
10. Peter A Tama´ S & Chizu Sato. 2012. "Is the non-unitary Subject a Plausible and Productive Way to Understand Development Bureaucrats?" *Third World Quarterly*, 33 (8): 1511–1525.
11. Karin Knorr Cetina and Alex Preda, eds. 2013."The Oxford Handbook of the Sociology of Finance. New York: Oxford University Press".

12. Jeff Galak, Deborah Small, and Andrew T. Stephen. 2011." Microfinance Decision Making: Afield Study of Prosocial Lending" *Journal of Marketing Research*, 48: 130–137.
13. PAUL RIPPEY and HARI SUBHASH. 2013."Crossfire: We need to be cautious about accepting CSR funding for economic development initiatives since benefit to disadvantaged producers may not be the ultimate goal" *Enterprise Development and Microfinance,* Practical Action Publishing 24 (1).
14. Douglas Mair, Anthony J. Laramie. 2000. "Capitalism and democracy in the 21st century: a Kaleckian interpretation of a Schumpeterian problem", *J Evol Econ* 10: pp.35-48
15. Karim Harji, Alex Kjorven, Sean Geobey, Assaf Weisz. 2012. "REDEFINING RETURNS: Social Finance Awareness and Opportunities in the Canadian Financial Sector"..
16. Harnessing the Power of Social Finance. 2014. Canadians Respond to the National Call for Concepts for Social Finance.
17. Social Finance in UK. 2014. Design Council.
18. Sonal Shah and Kristina Costa. 2015. "Social Finance: A Primer Understanding Innovation Funds, Impact Bonds, and Impact Investing", Center for American Progress.
19. Marjorie Kelly.2012."GTI PERSPECTIVES ON CRITICAL ISSUES, the Architecture of Enterprise: Redesigning Ownership for a Great Transition", p. 1-7.
20. Wilson, K. (2014), "New Investment Approaches for Addressing Social and Economic Challenges", OECD Science, Technology and Industry Policy Papers, No. 15, OECD Publishing.
21. Social Finance INC. 2012. "A NEW TOOL FOR SCALING IMPACT: HOW SOCIAL IMPACT BONDS CAN MOBILIZE PRIVATE CAPITAL TO ADVANCE SOCIAL GOOD, Social Impact Bond: An Overview.
22. Hanna Azemati, Michael Belinsky, Ryan Gillette, Jeffrey Liebman, Alina Sellman, and Angela Wyse. 2014. "Social Impact Bonds: Lessons Learned So Far" *Community Development INVESTMENT REVIEW.*
23. Social Finance. 2012. "Sector for Global Development, Investing in Social Outcomes: Development Impact Bonds "The Report of the Development Impact Bond Working Group.
24. Business Today, April 12, 2015.