

Impact Exchanges - The Enabler of Social Development Goals

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Abstract

Social Enterprises (SEs) are key to uplifting backward sections of the Indian society. While they comprise both non-profit organisations (NPOs) and for-profit organisations (FPOs), their pervasiveness can be gauged from their sheer numbers and impact. For example, there are nearly 31 lakh NPOs in India – nearly one for every 400 Indians. These SEs are considered instrumental in helping India's citizens through social and financial re-inclusion. Key to their success, apart from operational aspects, are the financing aspects. As these SEs assume greater importance in times of severe disruption in the livelihoods of people due to COVID-19, policymakers have been pushed into exploring new ideas to support them. The Social Stock Exchange (SSE) is such an idea whose time has come. SSEs are exchanges similar to stock exchanges, but where the SEs can list to raise funds. However, there still remains the question of why SSEs are required when the investors could directly search for the relevant SEs. What would the SEs gain by listing on SSEs and potentially undergo greater compliance checks and regulations, when they could spend those resources on their core activities? The first reason is that an SSE listing would open the doors for the social enterprises to new sources and alternative fundraising structures that they have conventionally not been able to tap. The second reason pertains to the investors in the SEs who are equal stakeholders in the SE's process. The SSE listings are designed to aid both individuals and corporations by offering better SE-discovery, SE-evaluation, and greater operating transparency in the workings of recipient SEs. These are expected to make individual and CSR investment decisions more efficient and effective, thereby attracting more capital to the overall pool. This research paper explores the concept of the social stock exchange, social enterprises, social finance, and impact investment. It focuses on the

structure and operation of the social stock exchanges across nations. The Indian Government's proposal for establishing an SSE in 2019 Union Budget has also been covered in this paper. The paper further considers the possible problems in setting up an SSE for the social ecosystem in India. Finally, the author proposes recommendations to help the SSE achieve its prescribed goals.

Keywords: Social Finance, Impact Investment, Securities Exchange Board of India, CSR, Social Entrepreneurs, COVID-19

INTRODUCTION

The sole purpose of social entrepreneurs is to lower social problems and enhance the quality of life of society or a specific population. Social businesses include both non-profit organisations and for-profit organisations. The sole purpose of establishing such businesses is to empower the society and the economy; however, they are having a tough time finding long-term finance. The social stock markets will enable in reducing the gap in financing. The major distinction between social and traditional entrepreneurship is that social entrepreneurship's goals are linked not only to profit generation, but also to attaining a social or environmental consequence.

SOCIAL FINANCE

The phrase 'social finance' refers to the creation of a new market model distinguished by a variety of complex structures, instruments, and participants. This is a type of financial service that tries to use private cash to address issues of social and environmental concern. The concept relates to a dualistic way of thinking in which traditional

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economic principles are followed to achieve social and environmental goals. Its development has recently been marked as “a parallel social economy with its own institutional and governing structures”. The concept of social finance gained attention in the aftermath of the Global Financial Crisis (2008). It influences critical decisions about allocation of funds, the rise of new markets, new company structures, and new commodities.

This finance is then invested in businesses involved in the uplifting of underprivileged groups, by providing them goods and services such as medical facilities, employment opportunities, loans, and so on.

IMPACT INVESTMENT

The investment made by social enterprises is described by a different term, called impact investment. As the term suggests, impact investment is the investment made in businesses with the aim of having a distinguishable social, economic, and environmental impact. At the same time it generates a wide range of returns, ranging from profit to publicity to creating awareness to mass education. The aim of double or triple bottom line returns on investment – economic, social, and environmental (ESG) – is alternately referred to as social finance. This is also known as shared value investing.

Impact investment can be seen as an alternate source of funding for socially valuable products and services. So far the government has undertaken this responsibility. However, now it entails deploying private capital as well. One of the biggest concerns that social entrepreneurs face appears to be attracting investment. There have always been investors who have been willing to put their money into ethical enterprises, but they demand assurances about their financial and social efficacy. As a result, the Social Stock Exchanges (SSEs) came into existence.

SOCIAL STOCK EXCHANGES

The SSE acts as an enabling platform. The social entrepreneurs who require funds and investors who are eager to invest their money for varied social causes can come together and bring about a sea change in the society.

SSEs are designed to help small- to medium-sized social enterprises who are looking to expand their operations but are having trouble raising the necessary capital from

conventional sources. This is a way through which markets can support the society, rather than the society supporting the markets. Investors can buy shares in these enterprises using SSEs in the same way that they would on the BSE/NSE. An investor might go to an SSE to look for a social enterprise with a mission that meets the interest of the individual.

They have been founded all over the world with the primary objective of channeling monetary resources to social enterprises. The structure and design of these ecosystems differ in accordance with the depth of the involvement of the corporate sectors in social and environmental development. The adherence to guidelines on disclosure and reporting norms given by the government ensures transparency in the functioning of the social sector.

RATIONALE OF THE STUDY

The present study on Social Stock Exchange has been undertaken to achieve the following objectives:

- To study the concept of the Social Stock Exchange along with other related concepts such as social entrepreneurs, social enterprises, and social finance.
- To analyse the emergence and functioning of Social Stock Exchanges in different countries across the globe.
- To study the proposal of the SSE and its relevance in the Indian context.
- To suggest measures to improve the working of the Social Stock Exchange in the Indian domain.
- To analyse the importance of Social Stock Exchanges in the wake of COVID-19.
- To understand the option for deploying CSR funding through the SSE.

RESEARCH METHODOLOGY

Data Collection Method

The methodology used for this research paper is descriptive. This research paper is based on secondary data. The approach to this study includes review of the literature, a comparative analysis, and previously conducted interviews.

Sources of Data Collection

The data for the present study has been taken from various publications of SSEs, journals, articles, and websites, including the SEBI and the MCA. For this purpose, the budget statement of July 2019 has also been thoroughly examined. In this research paper, the analysis with respect to the framework set forth by the reports of the committees with the globally established practices has also been incorporated. To understand the importance of the Social Stock Exchange in the wake of COVID-19, various reports on integrating CSR and SSE have been examined.

SSE – A GLOBAL OUTLOOK

Bolsa de Valores Sociais and Ambientais (BVS&A – Social & Environmental Values Exchange)

In 2003, Brazil became the first country to establish a Social Stock Exchange. BVS has raised funds for educational projects run by Brazilian non-governmental organisations. It has been working for the environmental projects ever since it became BVS&A. Since then, numerous other countries have followed suit, including the United Kingdom (UK), South Africa, Singapore, Canada and Kenya. A majority of these SSEs surfaced during the first few years of the decade.

United Kingdom

The concept of SSE originated in the United Kingdom with the report 'Enterprising communities: Wealth beyond welfare' by the Social Investment Taskforce (SITF).

The London Social Stock Exchange is more of a directory that aligns social entrepreneurs with future investors. It was founded in 2013 and only considers companies that fulfil an independent social impact evaluation.

South Africa

South Africa has taken a leading role in addressing social development issues. It has the world's first SSE, which opened its virtual doors in June 2006. 'South Africa Social Exchange', or SASIX, is the name of the exchange. It

functions in the same way as a traditional stock exchange. It provides impact investors with a unified platform for purchasing shares in welfare projects, based on two categories: sector and province. Animal protection, education, and health are some of the sectors offered by SASIX.

Singapore

The Rockefeller Fund supported the establishment of IIXA in Singapore in 2012. This is the only public SSE. It became operational in June 2013. It functions as a centralised marketplace for social projects. In contrast to SASIX and BVS&A, IIXA is expected to issue securities (shares, bonds) on a regular basis; however, social entrepreneurs, not NGOs, are expected to act as issuers. The amount of money made by investors is determined by the number of securities purchased and the market price of those assets. The selection of social initiatives is based on a uniform assessment approach that considers a company's ability to engage in social transformation, as well as its financial situation. Every business is required to maintain financial and social reports that are examined and analysed by the experts.

Canada

In September 2013, Social Venture Connexion was launched. It connects the social enterprises to investors who relate well to the cause. This platform enhances their presence. SVX provides a public portal that exposes pertinent financial, social, and environmental data on local impact ventures that are members. It also offers a private gateway for accredited investors and debt or equity issuers to gain access to additional information. Retail investors can also engage in investing on this platform.

Kenya

Both Africa and Asia have made great strides in the field of SSE. The Kenya Social Investment Exchange (KSIX) was founded in 2011 to showcase the social enterprise investment potential in Kenya. Based on previous social investment successes in Africa and two years of active study and preparation, KSIX contacted interested investors (both national and international) to confirm their eligibility and discover suitable debt investment possibilities.

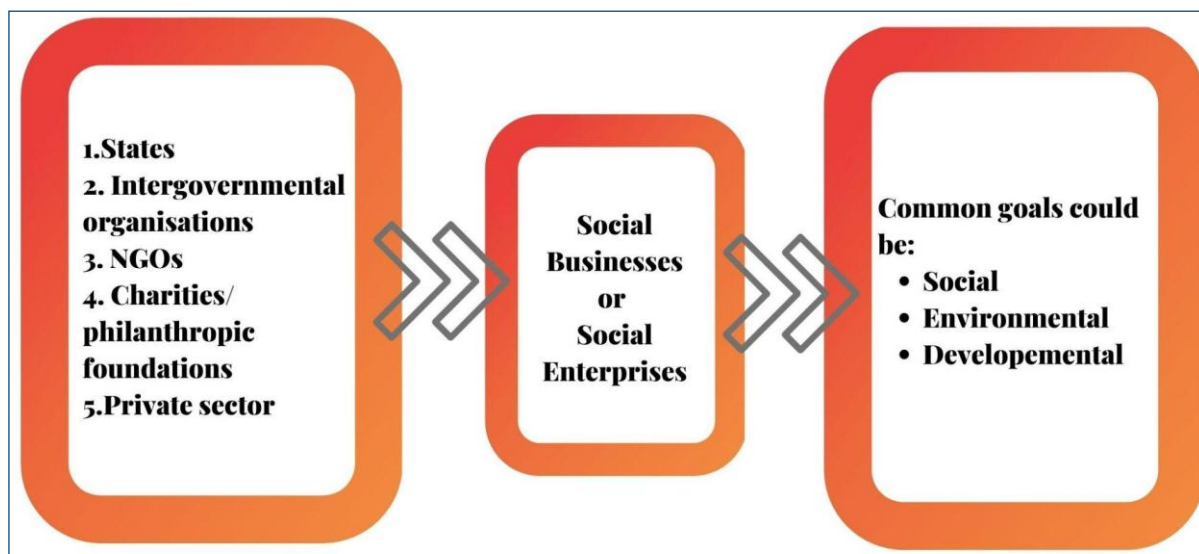


Fig. 1: The International Social Development Architecture

SSE – THE INDIAN SCENARIO

The SSEs were founded on the grounds that the funds invested towards social welfare, monetary and non-monetary backing, and philanthropic initiatives have not been very effective. Global developments in ethical corporate practices and regulatory frameworks have been important catalysts for reform in Indian laws.

The formation of an SSE under the ambit of the SEBI and raising capital by social enterprises and voluntary organisations can be traced back to the Finance Minister's 2019-20 Budget Speech. Consequently, on September 19, 2019, SEBI established a working group on SSEs, chaired by Shri Ishaat Hussain. The Working Group's (WG) report outlined the framework for SSEs, including the definition of a social enterprise, the types of fundraising tools that can be used within that framework, and uniform reporting processes. On September 21, 2020, under the Chairmanship of Dr. Harsh Kumar Bhanwala, a technical group was formed by the Securities and Exchange Board of India. The report of the technical group was made public on May 6, 2021. The report includes qualifying criteria, as well as a comprehensive ecosystem in which such an SSE would operate.

This is a pertinent move taken towards India becoming a participant in the developing impact revolution. Globally, responsible, sustainable, and impact investments increased by 17 per cent each year. In 2016, the figure

stood at USD22.9 trillion. It went up to USD30.7 trillion in 2018. India can optimally avail this opportunity to turn its impact sector into another IT/ITES, and enhance growth and employment. It also has a chance to become a major player in the impact revolution.

How Does the SEBI Report Help India's Social Enterprises?

SEBI has defined a social enterprise as an enterprise which is truly involved in creating a deep social impact. Such enterprises are of two types – non-profit organisations (NPO) and for-profit enterprises (FPE). A clear-cut definition of types of SSEs helps in setting guidelines for understanding and adherence, thus ensuring stability.

A system of continuous examination, inspection, and reporting of the utilisation of these monetary and non-monetary resources would lead to transparency and trust in the system.

In the short term, the SEBI report supports a "self-declaration" paradigm for social companies. This gentle approach to self-governance for non-profits, with a focus on voluntary compliance, will only be used to monitor their activities. Through enforcement or delisting processes, we need greater punishments for non-profit organisations that fail to comply with the required reporting and disclosure compliance.

COVID-19 AND SSEs

Government spending alone is not sufficient to achieve the goals of human development. Funds from socially responsible private enterprises are also required. Even though impact businesses are flourishing in the country, they are encountering challenges while securing funding. Following the COVID-19 epidemic, there is an immediate need for social capital to aid in the rebuilding of people's lives. One of the possible solutions to this serious problem is the SSE, as it will open up large pools of capital and allow social and commercial enterprises to grow vigorously.

The operation of SSE will have a significant contribution in upscaling for non-profits launching COVID-19 assistance initiatives in the country.

FUNDRAISING: ALTERNATIVE APPROACHES

The SSE intends to judiciously employ fundraising avenues and systems accessible to social businesses under regulatory guidelines. These have been elaborated below:

For Non-Profit Social Enterprises

Zero Coupon Bonds

The NPOs can issue zero coupon bonds. This way they can list themselves directly on the social stock exchanges. Through this option these organisations can raise finances from various interested individuals and corporate social responsibility spenders. The period of the bonds issued would be the same as that of the task under consideration.

Social Venture Funds (SVF)

Social venture funds are mutual funds that invest primarily in the shares or units of "social enterprises". These include public charitable trusts, charitable societies, companies registered under Section 8 of the Companies Act, 2013, and microfinance companies. SEBI has permitted the selling of social venture securities or units to investors.

Despite the fact that investments in social venture funds have increased from INR24.30 crores in September 2013

to INR1,105.55 crores in March 2021, the rate of growth is modest when compared to the prospects.

Mutual Funds

Investors could be offered closed-end mutual fund units by an asset management firm. The units might be redeemable in principal, but the fund acting as the middleman could direct all of the profits to suitably selected non-profits.

Pay-for-Success Models

These approaches, including lending partners or grants, are cited as effective strategies for ensuring more efficient and accountable capital allocation.

Social/Development Impact Bonds

Social impact bonds are a type of instruments that already exist in India. Multi-stakeholder approaches underpin social/development impact bonds, which include an investor, a service provider, an impartial evaluator, and an outcome payer.

For-Profit Social Enterprises (FPEs)

These organisations are required to adhere to a set of listing and disclosure requirements, including financial operating procedures and governance guidelines. Social impact reporting is mandatory if these enterprises choose to list their shares on the SSE.

Social Venture Funds (SVFs)

FPEs can use Alternate Investment Funds (AIF) and SVF as sources for fundraising, but they do not necessitate social impact reporting. SSE would incorporate all FPEs under the ambit of minimum reporting standards that receive funds through the AIF/SVF channel.

Furthermore, the avenues of raising finance outlined for non-profits might be applied to FPEs. Despite the fact that there are no legal or regulatory barriers to their usage for this purpose, these capital pooling possibilities remain underused in India.

Deployment of CSR Funding through the SSE

CSR funds of companies are generally underutilised; therefore, the SSE platform can link qualifying entities with surplus and deficit spending. It has also been seen that the CSR spending by corporates is not target based. The achievements are not measurable and the impact of such spending by the corporations is not visible. By linking CSR spends via SSE might define a purpose. The result would be that the impact of these contributions would be apparent.

The high-powered committee on SSE of market regulator SEBI has suggested that companies which channelise a huge sum on CSR initiatives will soon be able to trade their excess components. Corporations that spend more than the CSR guidelines allow might sell their excess to companies that have not met their yearly requirements. Companies having excess CSR spending could list their certificates for selling on this platform. The concept is comparable to the Priority Sector Lending (PSL) certificate offered by the RBI.

India is the first country to make CSR a legal requirement. Companies with a net worth of ₹5 billion (USD70 million), an annual turnover of ₹10 billion (USD140 million), or a net profit of ₹50 million (USD699,125) or more are required by Section 135 of the Companies Act, 2013, to spend 2% of their average net profits over three years on Corporate Social Responsibility.

This research paper presents many new approaches for using CSR funds through these stock exchanges. These have been stated below:

- SSE funding should be approved to be counted towards a company's corporate social responsibility initiatives.
- CSR grants can be allocated and payment can be made to those projects in which a positive social impact is achieved.
- CSR investments can be swapped among corporates that have made excessive CSR expenditure and the corporations that have made low investments via CSR route.
- Corporates should be allowed to use their CSR funds to finance the capacity building activities of impact exchanges.

CHALLENGES

The challenges faced by the established SSEs are the following:

- *No Legal Criteria:* As there are no legal requirements to distinguish between a social company and a traditional business, it will be difficult to distinguish between the two.
- *Measurement of Social Influence is Difficult:* There is no universally acceptable methodology for measuring the influence on society.
- *Extent of Participation:* Several NPOs in India may not be in a position to comply with the listing and disclosure norms, as they are unregistered. They lack the means to keep their financial records up to date. Even though SSEs allow both retail and institutional investors, organisational investors are preferred.
- *Regulation Intermediaries in Social Effect Assessments are Regulated:* A new set of intermediaries, such as impact assessors, would be put in place by SSE. These assessors would weigh the impact of the social entrepreneurs' activity. Guidelines governing their registrations and area of work may be defined by the SEBI.
- *Return on Investment:* Determining the rate of return for investors is difficult for SSE. The ROI for social enterprise investments would be determined by the achievement of the goal under consideration.

SUGGESTIONS AND RECOMMENDATIONS

In addition, the paper makes the following valuable recommendations:

To cut back on commercial pressure to drift from achieving the social objective, SSEs should put a check on the investors before giving them access to the platform. The regulatory structure for the Indian SSE should clearly discourage those investors who want quick returns.

- To eliminate skewed information, some minimum standards for reporting on social effects have been proposed for both FPOs and FPEs. This includes setting up a 'capacity building fund', with a total of ₹100 crore, to help non-profits improve

their reporting capabilities. This fund would be structured through NABARD, SIDBI, and other stock exchanges. A new group of auditors, the social auditors, is expected to provide an independent verification of NPO impact reporting over time.

- Additional tax exemptions, incentives, and other favourable policy measures should be taken to enhance the acceptance of these funding structures across different types of investors.
- Setting up Self-Regulatory Organisations (SROs) and Information Repositories (IRs), which would be responsible for identifying non-profits, the actions, and aspects of the business. They will also provide reliable and relevant information about the NPOs before these are established.
- It has been suggested that India's SSE be set up under the umbrella of the country's current stock exchanges, the Bombay Stock Exchange (BSE) or the National Stock Exchange (NSE), as both are supervised by SEBI. The SSE in India will benefit immensely by using the BSEs'/NSEs' knowledge and networks. Since it is important to secure the SSE's social goal, it must have independent leadership and decision-making, with representation from the finance and investing spheres, along with the civil society, including different genders and underprivileged groups.
- A study conducted by the Impact Finance Network in 2018 looked at 150 social platforms. These included SSEs from South Africa, the UK, and Canada, and observed that 75% of the SSEs could not create enough revenue to cover their running expenses. Sixty per cent of these stock exchanges had around 1,000 users. This exemplifies that a revenue model should be in place from the onset. For the SSE in India, on the other hand, the Indian government is the driving force behind the setting up of the exchange.
- The government must initially assist with the development of impact markets. Once the initial stage of setting up is done, then an appropriate mix of legislation and policy instruments should be laid down for the smooth functioning of the SSEs. FPEs shall not be listed on the SSE only on the basis of self-reported social effects. To assure that only genuine FPEs can join SSE, SEBI should

devise a process for evaluating the credentials of the interested FPEs. The aspect of impact creation should be self-declared by the FPEs.

- Mass awareness campaigns should be launched for social businesses seeking to list themselves. This will ensure a positive response from the stakeholders and acquirer groups. The purpose of this measure is to establish a correct mindset in all investment decisions, by imparting knowledge.
- To boost the social sector's organisational ability, investors – local authorities or charitable organisations, must provide more initial funding. The availability of relevant information can also facilitate the interested investors to make more informed decisions.

CONCLUSION

The allocation of innovation, finance, and business are all influenced by social finance. In the current societies, it has an impact on the expansion of new markets, corporate structures, and commodities. The SSEs were a response from unorthodox actors, especially the private sector fund managers. India has the potential to be a major player in this impact revolution. By empowering its members to engage and interact smoothly with their global peers, the SSE must grab the potential to make India a prominent stakeholder.

The pandemic has clearly revealed that it is extremely important for the public and private financing sources to come together and work for social development.

Both public and private funds should integrate and formulate strategies which ensure easy transfer of finance to the social sector. More investors are encouraged to incorporate ESG issues into the appraisal of firms, thereby considering non-financial measures of performance as well.

Although a lot of SSEs include both non-profit as well as for-profit entities, the developed economies with well-established impact investment ecosystems prefer for-profit entities or revenue-generating charities. Those countries which are in the emerging stages are more welcoming of non-profits. A majority of SSEs and nations have decided to define 'social enterprises' legally.

SSEs typically list significant corporations. Project listings typically support causes that adapt themselves to a business model and/or are visible and conveniently quantifiable.

The SSE in India is being developed after giving due consideration to the characteristics and challenges faced by other SSEs across the globe. To ensure that it operates more efficiently, every step taken should be in synchronisation with the objectives. A supportive legal system should be put in place. To create and maintain confidence in the system, disclosure and reporting guidelines should be stringently adhered to.

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