Enterprise, Not Aid, for Social Change

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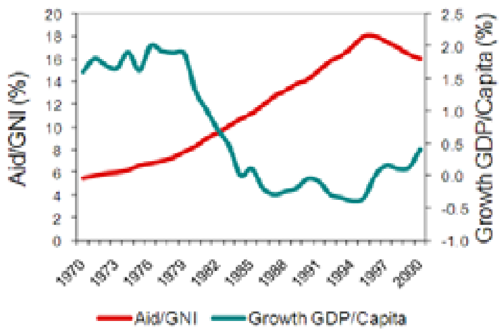
A wind of change is blowing through the world of aid and philanthropy. The old formula of aid and compassion doesn't work anymore. In its place, **Kim Tan** proposes a new model based on enterprise and financial capital.

After more than 50 years of aid and the equivalent of Six Marshall Plans to Africa,[1] there has been no significant change in the poverty landscape. Critics of aid—among them Bauer,[2] Esterley,[3] Jenkins,[4] Moyo[5] —have highlighted the failure and unintended consequences of aid.

More worryingly, economic data show that though aid has increased over a 10-year period, the GDPs of the recipient countries have decreased.

Figure 1: Aid and Income Growth in Africa (10 year moving average)



Source: European Centre for International Political Economy Analysis of World Development Indicators, 30 June, 2008.

Whilst aid to Africa, for instance, increased from 5% to 17% of GDP in the late 1990s, GDP growth actually decreased from 2% to zero or negative growth (see Figure 1).[6] The worrying conclusion: There is no demonstrable direct relationship between aid and poverty reduction.

Enterprise or Nothing at All

In my opinion, business and enterprise is a better, if not the only way, for long term sustainable transformation and poverty reduction in developing countries. The reasons for this seem obvious:

- The Asian Tigers—especially China and India—have transformed their economies through enterprise and foreign direct investments, not aid or philanthropy. In the process, they have lifted millions of their citizens out of poverty.
- The GDP of a number of Sub-Saharan African countries including Kenya, Uganda and Zimbabwe was higher than those of South Korea, Singapore, Taiwan, Malaysia and Hong Kong some 30 years ago. Today, this has been reversed despite the aid they have received.

To be clear, there will always be a role for aid and philanthropy in meeting humanitarian, short-term crises such as tsunamis, floods, droughts and violent conflicts. But for long term and sustainable transformation, aid is not the solution.

It is not the intention of this article to analyse the failure of aid to alleviate global poverty—that has been well documented by numerous authors. I would like, however, to highlight two key issues that are seldom discussed.

Corporate Tax Matters

The first is the difference in the make-up of the GDP between developed and developing countries. In the former, the small medium enterprise (SME) sector contributes, on average, more than 51% of the GDP of the country, while the informal sector—the part of the economy that is not monitored by the government, for example home-based business—contributes 13%. In developing countries, this is reversed with the SME sector constituting only 16% of the GDP, whilst the informal economy is massive, contributing more than 47%.[7]

With such a large informal sector from which no taxes are collected, it is not surprising that governments in developing countries have to depend on aid and philanthropy to run essential services like health and education. In other words, activities that promote the informal sector, however well intentioned, will continue to condemn developing nations to poverty.

Increasing the tax base is the way out of poverty; but the only way to enlarge the tax base is through enterprise-creating jobs and increasing corporation and employee tax receipts. Sadly, aid, philanthropy and even microfinance, however well intentioned, do not enlarge the tax base. Instead, they actually propagate the informal sector. The current crisis in the Euro zone is a classic example of what happens when governments cannot collect sufficient taxes because of a bloated informal sector that takes up 20% of GDP, as is the case in Greece, Spain and Italy. In Europe, these countries need a "bail out." In Africa, we just call it "donor aid."

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Finding the "Missing Middle"

I've already noted that the backbone of the economy in developed countries is the SME sector. This sector creates an average of 65% of the jobs in the high income countries compared with only 30% in the low income countries.[8] The absence of a strong SME sector has been called the "missing middle" in the developing countries and yet this is where the entrepreneurial and innovative drive of a country is to be found. Activities that do not enlarge the "missing middle" condemn the country to poverty.

To address this gap, various issues need to be tackled: Energy and transport infrastructures, access to capital, and bank lending practices, amongst others. In Sub-Saharan Africa, businesses looking to expand struggle to get access to capital. The angel and venture capital industry is nascent and under-developed. Bank loans, if available, have high interest rates, often ranging from 20–35%. Most businesses cannot afford to borrow at this rate and, in most instances, short term debt is not the right kind of financing that's needed for growth. Patient equity capital is what is needed, but this is largely unavailable.

To really help these countries out of poverty, we need to build the ecosystem so that SMEs can develop and grow. Without this, there will be no growth of the middle class and nations will continue to have unbalanced economies that are skewed towards the informal sector.

Figuring Out the Social Impact

Even if we believe that enterprise-building is the best way to tackle poverty, can it also address the social issues of human trafficking, HIV/AIDS, literacy, conservation, global warming and the environment? I believe it can, with some adjustments to the investment criteria.

Investments can be made with the intention not only of a financial return, but also a social and an environmental return. We call this social venture capital, or impact investments. We look at a social need and design or support businesses that can address these needs whilst achieving a financial return. We take an enterprise approach to poverty alleviation by building commercially sustainable SMEs that create jobs, empower the poor to improve their livelihoods and address their social and environmental issues. We apply the same principles and accountability as traditional venture capital but adjust for the triple bottom line of financial, social and environmental returns. This is not an easy form of investment for it requires patient capital, local mentoring and capacity building.

A number of groups, foundations and funds have been engaged in investing in this new asset class for a number of years. They include the Shell Foundation, Omidyar Foundation, LGT Venture Philanthropy, Pearson Foundation, Calvert Fund, Springhill, and the Transformational Business Network (TBN).

The box below shows examples of how some aid and philanthropic organisations are tackling social issues through commercial for-profit social ventures.

Examples of Social Ventures

Hagar International[10]
Addresses trafficking, women issues, and education in Cambodia, Vietnam, Afghanistan

Pierre Tami founded Hagar International over 20 years ago to rescue women and children from trafficking and abuse. Today, Hagar has over 600 children and women a year in their shelters. Three businesses under the Hagar Social Enterprise Group employ over 300 people, mostly women.

Social Value: Employment helps socially, economically and politically vulnerable women gain their independence, dignity and re-integration into society.

Soya Factory Cambodia

The Paradigm Project[13]
Addresses health, de-forestation, incidence of rape

Greg Spencer started this project when he designed a cook-stove that is 50% more fuel-efficient compared to traditional open fire cooking. It also takes out 85% of the smoke and toxins that are so detrimental to the health of the women doing the cooking.

In addition to the health issues, open fire cooking is both a fire hazard and a serious environmental problem as a result of deforestation.

Paradigm manufactures its cook-stoves in Kenya and, through carbon offsets, is able to subsidise manufacturing costs while still making a financial return for investors.

Social Value: The deforestation also has a knock-on effect. Women and girls are usually the ones sent to collect firewood. With increasing deforestation, they have to walk further to find wood. This is time that should be spent on their schooling. Also, the further they walk away from their villages, the higher the risk of rape. Addressing the energy problem has a positive ripple effect.

By 2020, Paradigm targets to impact 3.5 million people, save US$11.5 million of household income through decreased fuel consumption, save 7.8 million trees and trade 3.6 million metric tonnes of CO_2.

Cook Stove by Project Paradigm

Bulembu[14]
Addresses HIV, education

A group of Canadian businessmen led by Volker Wagner bought the ex-mining town of Bulembu (5,000 acres) with the vision of housing 2,000 HIV/AIDS orphans out of the 120,000 in the country. They will be housed in 1500 houses run by house parents.

In Swaziland, HIV/AIDS rose from 3.9% in 1992 to 38% in 2002, a 900% growth that gives the country the dubious distinction of the world's highest prevalence of HIV. With a population of 950,000, a life expectancy of 32 years and minus 0.4% population growth, the Swazi people will become extinct by 2050.

Social Value:
Bulembu runs a number of profitable businesses to support the work of the orphans, education and clinic services including timber extraction, honey production and tourism.

A beneficiary of Bulembu.

Kuzuko Lodge[11]
Addresses HIV, climate change, conservation

Kuzuko is a 40,000 acre game reserve in one of the poorest regions of South Africa's Eastern Cape. It has a 5-star lodge offering eco-tourism and a safari experience that's operated by the Legacy Hotel Group. It is one of the largest employers in a district with 70% unemployment.

The land has been rehabilitated and, in partnership with the South African National Parks, game has been re-introduced with conservation programmes for the black rhinos, elephants and Cape Mountain Zebra.

A programme of re-forestation with the indigenous spekboom shrub is about to commence.

Social Value: It employs a significant number of AIDS orphans and disadvantaged youths who are trained in a variety of roles as game rangers, chefs and general hospitality.

There is a growing awareness among conservation agencies that unless the economic needs of the poor are addressed, their conservation efforts will not succeed.

The spekboom shrub captures carbon and improves water retention of the soil, and has been approved for carbon trading. With the carbon credit, Kuzuko plans to re-forest some 14,000 acres of degraded land over a two-year period which will create 300 jobs.

Kuzuko Lodge

Bridge Academies[12]
Addresses children's education in the slums of Kenya

Jay Kimmelman founded this private school-in-a-box franchise for primary school education in the slums of Nairobi. Both the size of the school and classrooms are specified, and lessons are scripted. Parents pay US$4 per child per month via M-PESA, a mobile phone banking system.

Their vision is to build 1,000 schools to educate a million school children in Kenya. The company is building one school a week, and currently has 70 schools.

Social Value: With better motivated teachers and parents taking a keener interest, standards are significantly better than government-run schools. Results for literacy of Grade 1, 2 and 3 pupils are 50-100% better than their peers in the government schools.

Students at Bridge Academies

Of course, poverty is a complex problem. Its causes are multifactorial, but we have focused too much, and for too long, on these causes. Perhaps we should spend more time focusing on the causes of wealth creation and economic development. It is time for governments and foundations to allocate part of their budgets to social venture capital investing. The goal must be to stimulate wealth creation, to enlarge the SME sector, and increase the tax base of countries that would otherwise be condemned to be dependent on donor aid. This is the journey we need to take from aid and philanthropy to enterprise.

[1] Peter Tamas Bauer & Cranley Onslow, *Fifty Years of Failure* (Centre for Policy Studies, 1999); Brian Griffiths & Kim Tan, *Fighting Poverty through Enterprise* (TBN, 2007).

[2] Peter Tamas Bauer & Cranley Onslow, *Fifty Years of Failure* (Centre for Policy Studies, 1999).

[3] William Easterly, Ross Levine and David Roodman, "New Data, New doubts: A comment on Burnside and Dollar's Aid, Policy and Growth," Center for Global development NBER Working Paper No. 9846 (2003).

[4] Simon Jenkins, "OpEd," *The Times*, 26 June 2003.

[5] Dambisa Moyo, *Dead Aid: Why aid is not working and how there is another way in Africa*, (Allen Lane, 2009).

[6] "World Bank Development Indicators," (World Bank, 2003).

[7] Meghana Ayyagari, Thorsten Beck and Asli Demirgüç-Kunt, "Small and Medium Enterprises Across the Globe: A new database," World Bank Research Policy Working Paper 3127, August 2003.

[8] Ibid.

[9] TBN is a network of investors, entrepreneurs and business people who are disillusioned with writing philanthropic cheques and who, instead, prefer to invest their time, talent and money in building enterprises among the poor. Since 2004, TBN's 1500 members have invested in over 65 projects in over 15 countries to create over 20,000 jobs. TBN networks are being formed in several countries to mobilise local business people to engage in this form of investment. Its members are creating various forms of investment vehicles to attract more capital for social venture capital, revolving credit loan funds, fund of funds and listed holding companies.

[10] www.hagarinternational.org.

[11] www.kuzuko.com; www.kuzukolodge.co.za.

[12] www.bridgeinternationalacademies.com.

[13] www.thepraradigmproject.org.

[14] www.bulembu.org.