

# **Enterprise against poverty: The case for Social Venture Capital**

**Dr Kim Tan**

**First Edition (Oct 2003)**  
**Second Edition (Dec 2005)**

**©*Dr Kim Tan, (Oct 2003)***

## ***Global Poverty – An on-going scandal***

We all know the statistics. About 50% of the world's population lives on less than US\$2 a day – that is a staggering 2.8 billion people. Of these 1.2 billion live on US\$1 a day. Imagine a population twice the size of USA, Canada, Mexico and Brazil living on the price of a can of coke a day.

On top of the existing poverty, we have the devastating effects of disease in the poorest nations. At the end of 2002, an estimated 42 million around the world were living with HIV/AIDS. 30 million of these live in Sub Saharan Africa.

Add to this the status quo of disparity - the richest 20% of the world's population own 77.3% of the world's wealth whilst the poorest 20% own 1.4%.

Most of us have become numbed towards these kinds of statistics. We have developed '**poverty fatigue**'. Poverty is only a problem when we watch our television screens or when we travel. The odd moments of conscience we may have can be ignored or tolerated. The problem is so insurmountable that we do not feel we can motivate ourselves 'yet again' to think about it, never mind tackling it. We have become highly de-motivated about poverty. Cynicism killed off hope a long time ago. As we are reminded, "the poor you will always have with you", so why bother?

Thankfully for the poor of the world, governments and NGOs have not abandoned them completely.. Failed them, maybe. But at least they are trying. Why? Perhaps it is because they are aware that a nation's greatness is not measured by its GDP or military expenditure, but by its compassion towards the poor. Countless foundations around the world give millions to charities each year. We have also seen great waves of generosity under the leadership of celebrities such as Sir Bob Geldorf and the Live Aid concerts, Sting and Bono.. These are all signs that there is something in all of us that cares about our fellow human beings, about justice and a fairer world for everyone. But despite all these efforts, we have growing poverty in the world. Why? The simplistic answers would be that the poor countries are corrupt and squander most of the aid monies, or that NGOs are inefficient in the distribution of aid or worse still, that the poor are lazy and do not want to help themselves, preferring to live on hand-outs.

The truth however is that global poverty is a complex, multi-factorial problem. Sure, some are poor because their corrupt leaders have plundered the country and saddled them with debts as a result of buying armaments and building dams they do not need. They have forgotten that **their poor need medicines, not missiles**. And of course these are debts which can no longer be serviced. And unless there is debt relief and restructuring for these countries, they will remain in this cycle of debt-perpetuated poverty - one of the systemic causes of poverty. In countries where civil wars are raging, there can be no economic prosperity either. Other countries however are poor because their leaders have not embraced technological changes. 30 years ago, Mexico had a higher GDP than

South Korea. Today this is markedly reversed. Why? Because South Korea embraced the new technologies whereas Mexico did not. To do so however requires governmental leadership, an educated workforce and inward investments. But what if you do not have any of these? What do you do, apart from despair?

### ***Responses to global poverty***

The complexity of the underlying causes of poverty requires a multi-pronged approach.

#### **1. Aid & Development**

Traditionally, the development agencies have focussed on providing aid to poor countries as a means of tackling poverty. While aid and disaster relief (humanitarian assistance) remain important in helping the developing world, governments and NGOs have recognised that aid alone is insufficient to alleviate the problem of endemic poverty. Likewise, development projects have an important role to play in education, caring for the vulnerable, skills training and community-based handicraft and subsistence-farming. However because they are not self-sustaining projects, many such projects run out of support after a while.

Simon Jenkins of The Times (UK) is a well known critic of aid. In his leader on June 26, 2003 he describes aid as a continuation of the colonial Empire because it assumes the superiority of Western capitalism and governance. The 'poison of aid' Jenkins argues, has led to economic distortion and dependency. It has corrupted even good men such as Zambia's Kenneth Kaunda and propped up the world's worst dictators, from Bokassa and Amin to the modern rulers of Zaire and Zimbabwe.

In relation to Africa, he asks and answers the question: "What would I do? I would impose an arms embargo on Africa...I would restrict foreign aid to health and education projects on the ground. I would treat all past debts as "bad" ones, as morally corrupt. There would be no more construction contracts, no defence agreements, dams or office blocks, no more kickbacks, sweeteners, commissions or skim. **There would be no more telling Africa its business.** The one help that Africa needs is trade. It needs Western markets open to its primary produce."

Whilst we may not entirely agree with his prescription, we certainly have a lot of sympathy with his views. Jenkins was echoing other critics of aid, including the far-sighted economist, Peter Bauer. In his 'Fifty Years of Failure' he concluded that foreign aid ends up harming the poor in developing countries because amongst other things,

- it encourages inefficiency and waste. Much aid money has been squandered on prestigious projects that have allowed local politicians to 'skim off' money for themselves.
- it distorts local economies. Poor countries do not have the capacity to absorb huge inflow of aid dollars. When large amounts of aid money is spent on local goods and services, it has the unintentional effect of increasing real currency exchange and inflation rates that could end up hurting many of those the aid policies are designed to help.
- it empowers Third World governments to pursue their perverse political agenda because foreign aid is government-to-government: from land grabs, 'villagisation' of agriculture ending with reduced food production, subsidized national airlines to ethnic cleansing policies.
- it does not contribute to economic growth – Whilst aid to Africa increased from 5% to 17% of GDP in the late 1990s, GDP growth actually decreased from 2% to zero or negative growth (World Bank Development Indicators, 2003). There is no demonstrable relationship between aid and poverty reduction.

And one can add more to this. The World Bank has estimated that 60% of all foreign aid stays within donor countries going towards consultants, purchase of nationally produced goods and transportation costs. The charitable, NGO and philanthropic sector in the USA alone is an annual US\$240b industry. This is a huge 'Third Sector' with vested interests in the aid business. There are a lot of jobs, money and institutional interests at stake.

"Most aid still goes to corrupt governments. National and international aid bureaucracies, in alliance with assorted consultant, academics and NGOs, have a vested interest in the aid business, mostly with little regards to policy results.(Journal of the Institute of Economic Affairs, Dec 2003)

In their influential paper, World Bank economists, Burnside and Dollar showed that "aid has a positive impact on growth in developing countries with good fiscal, monetary and trade policies, *but has little effect in the presence of poor policies.*" Their first conclusion that aid has some positive impact in countries with good policies has not been substantiated by Easterley and others when their data was re-analysed using a larger sample size of countries and extending the data line from 1993 to 1997. Their second conclusion, after 50 years of aid, is now surely self-evident. Historical evidence suggests that good governance and policies help economies grow and reduce poverty *whether they receive aid or not*. In other words, when countries have good policies and governance, they really do not need aid. But when they do not, aid is wasted anyway. The current initiative by the British Chancellor, Gordon Brown to double the aid money between now and 2015 is probably not the answer unless some 'selectivity' was applied.

## **2. Micro Enterprise Development (MED)**

Western governments have committed themselves to helping the developing world through supporting MED in developing countries in order to facilitate sustainable development. However, to date it has proved difficult for the governments to focus effectively on MED, with its conflicting funding requirements.

Between 2000 and 2001, the UK's Department for International Development (DFID) dedicated just 4.8% of its budget to fund industry overseas. This is a shame because MED is at least attempting to give the poor some self-reliance and dignity through economic activity.

One of the few success stories in poverty reduction in the past 30 years has been the development of the micro-finance institutions (MFIs) that provide small (a few hundred dollars) un-collateralised loans ("micro-credit") to poor entrepreneurs to start up micro-businesses. The loan repayment rate is exceptionally high (usually >90%) among MFIs especially if loans are made to women rather than men!

Since its humble beginnings in 1971, when Opportunity International, a Christian not-for-profit organisation, began lending in Colombia and ACCION International in 1973, microfinance has grown to a multi-billion dollar industry. In 2004, the IFC through its partners have a combined loan portfolio of \$2.5b and serve over 1.3 million small entrepreneurs in developing countries.

The Grameen Bank which started in 1976 has become famous for its model of offering microcredit to women in small groups. To qualify, Grameen's female customers have to earn less than a dollar a day. Group members are required to monitor each other at weekly meetings, applying varying degrees of pressure to ensure repayment. As loans are repaid, people are allowed to borrow more. The group in effect replaces the security that pawnshops gained from collateral. The model is not perfect, but it does work and lifts people out of abject poverty. Such is the success that mainstream banking groups such as Citigroup and India's ICICI are now entering the market. Surely this is a better way to assist the poor to become independent without the use of aid.

## **3. 'Fair Trade'**

All the major governments have signed up to the Doha Declaration of the World Trade Organisation (WTO), which seeks, by 2005, to establish a fair and market-oriented international trading system through a programme of fundamental reform. They propose to 'make trade fair' by lifting artificial trade barriers and reducing subsidies to farmers in rich countries in order to give farmers in poorer countries a fair opportunity to sell their goods both at home and overseas.

Sadly, the failure of the WTO discussions in Cancun, Mexico, in 2003, cast into doubt whether or not the goals of the Doha Declaration will actually be met by

2005. This however is just the kind of help the poor nations need. But it is the one help that they will not get. **The West professes free trade but practises protectionism.** Look at the farm subsidies of the EU, the USA and Canada, and the USA's steel tariffs. A level playing field in the area of international trade is a mirage. These subsidies which total over \$300 billion per year, are larger than the combined national income of Sub-Saharan Africa and dwarf the \$50 billion given in aid a year. To put it more starkly, the dairy subsidy in the EU is \$2.50 per cow per day whilst 2.8 billion people live on less than \$2 per day. In other words, European cows are worth more than half the world's poor.

Furthermore it is doubtful if a reform of international trading laws on its own will automatically stimulate trade. Unless local people are effectively trained, encouraged and supported to get into business, they will be unable to benefit from the immense potential that domestic and foreign trade have to offer. *'Supporting the continued reduction in trade barriers world-wide will not help developing countries greatly unless there is a simultaneous commitment to improve the capacity of those countries to take advantage of new trading opportunities which arise.'* (DFID, *Trade Matters* p.22)

#### **4. Social Venture Capital**

Alongside these traditional approaches, there is a growing movement to use business enterprise to combat poverty. This movement has grown out of entrepreneurs using the same skills and expertise that have enabled them to build successful businesses and applying their talents and resources to the problem of poverty.

We call this approach Social Venture Capital or social enterprise. So what are these social enterprises? They are either for profit or not-for-profit social venture fund investing in small-medium-size enterprises (SMEs) in developing countries. They take an enterprise approach to poverty alleviation by building commercially sustainable companies that can create jobs and empower the poor to improve their livelihoods.

Henry Ford once said: "A business that only makes money is a poor kind of business". He should know. Most businesses exist solely to make a profit for their shareholders – that is the financial bottom line. Social VC looks beyond that to **the 'Quadruple Bottomline' – financial, social, spiritual and environmental returns.** It is not investing purely for a financial return. That is not to say that it is in it to lose money. In order for the businesses to be sustainable, they have to be profitable. But social VC does not require the same rate of financial return because it is also looking for social, spiritual and environmental returns. A number of these social VC entities are faith-based. The experience is that faith-based investors are more likely to accept a lower financial return in exchange for higher social returns. They are more able to align their financial interest with their social responsibilities. A growing number of successful entrepreneurs with a

philanthropic attitude are also allocating a small percentage of their total portfolio to this form of investment.

### **Why SMEs?**

The small and medium-sized enterprise (SME) sector has traditionally been seen as important to any economy for various reasons:

- **Mechanism for job creation**  
In developed countries, SMEs are responsible for employing around 70% of the work force. In the developing countries, this could be higher. In most countries, SMEs employing <100 people represent 99% of all registered companies
- **Higher success rate**  
Most businesses fail because they are too small and under-capitalised. SMEs that are properly capitalized and managed, have a higher rate of success
- **Source of entrepreneurship and innovation**  
SMEs provide an ideal environment for training in all aspect of business and are also where new entrepreneurs are groomed. 75% of all new businesses are started by people who have been previously employed in another company. In the develop countries SMEs are also known for their innovations because they can respond quickly to market demands
- **Driver of competition**  
SMEs drive competition usually through their numbers. Competition in turn will drive innovation leading to new businesses startups.

The SME is the next step up from microfinance. It offers the advantages of scale and size to create more employment, raises the success rate and provides the environment for on-the-job training and learning, even if it is via osmosis. The merits of this approach deserve further analysis.

- ***It makes sense:*** Investing in sustainable businesses creates employment in the developing world. Real employment gives people the dignity and self-determinism to transform their own communities. This is in contrast to the dependency culture often engendered by aid. The strategy is to provide a 'hand-up not a hand-out' in order to alleviate poverty. Is it a surprise that poverty is linked to unemployment? **What the poor want is not aid, but jobs** – real jobs, not subsidised ones. This is the dignity and self-reliance they deserve.

One of the problems with aid, is the need to keep asking donors for repeated support. In many cases donor fatigue eventually sets in. With social VC, funds can be provided either as charitable giving, equity investment or loan. **Donors become investors.** And we all know that investors are more likely to take an interest in their investments than donors in their gifts.

- ***It has worked before:*** 30 years ago, the South East Asian countries were

economic nobodies, their economies based on low priced commodities. Then Japanese companies started setting up manufacturing plants and were welcomed with open arms by the Asian governments. Why? Because they provided jobs for their people as well as trained them in new technologies. Within a few years, enterprising Asians, trained by the Japanese began starting their own plants, often in competition with their 'masters'. The rest as they say is history. Today the largest chip manufacturers are in Taiwan, Singapore and Malaysia - all locally owned. This is the Asian Tiger model. Whilst the Japanese companies did not have a social transformational agenda when they invested in Asia, nevertheless it demonstrates powerfully how **enterprise can alleviate poverty**. The key to reducing global poverty is economic growth. The most dramatic examples of this in recent years have been China and India. We are seeing China emerging from being a developing country to join the league of developed nations. This time it is through the Foreign Direct Investment (FDI) of companies from the USA, EU and other Asian countries. If it has worked in Asia, it will also work in Africa. Sadly, Africa with 12% of the world's population has only 1% of global trade. In 2001 only 1.4% of global FDI went to Africa. Strip away oil investments, this reduces to zero. Africa cannot transform itself without trade investments.

- ***It is still working:*** Here are some case studies:
  - ***Kuzuko Game Reserve, South Africa***([www.tbnetwork.org](http://www.tbnetwork.org); [www.kuzuko.com](http://www.kuzuko.com)) is a 39,000 acre game reserve situated adjacent to Addo Elephant Park (second largest after Kruger National Park). Its partner is the South Africa National Parks (SANP). The land is now fenced and disease-free animals indigenous to the region are being staged released by SANP. It will offer a safari experience to tourists in a 5-star lodge managed by Legacy Hotels, a leading hotel group in Southern Africa. It will employ 100 people directly when it opens. This project combines conservation, job creation, social and spiritual transformation in a region of 70% adult unemployment. And it is in a malaria-free zone. Other local partners include a number of financial agencies including the Disability Employment Concern Trust, South African Development Bank and the World Bank. A Workers trust has been created to enable employees to become shareholders in the business. The UK Foreign Office seconded an officer for a year to see first hand the project take shape. With their support, new commercially-viable business opportunities are currently being assessed with the aim of creating further jobs in the area.
  - ***Brains Group, UK and Moldova*** ([www.brainsdirect.com](http://www.brainsdirect.com)) This is a software outsourcing business. The marketing office is in the UK but the software engineers are based in the tiny country of Moldova in Eastern Europe, where it employs 100 technical people. What is exciting is that these 100 employees are taught new skills; they are learning about how businesses are run and they are taught integrity

and the taxes they pay represent a significant percentage of the total tax revenue of Moldova with about 4m people.

- ***Small Business Workshops, a former Soviet Republic:*** This is the testimony of the entrepreneur who started this project: 'I went to a former communist country and taught 'Small Business' workshops to some local people. To my surprise most of those attending were pastors and I asked why they were there. They each said, "Unemployment is at 65% percent, and I pray for my people, but one day I'd love to be able to give them a job." The workshops made such an enormous impact. Over the past few years, 81 new businesses have sprung up in the villages and towns where I ran the workshops. These enterprises currently employ over 2000 people, thereby providing for the needs of around 12,000 individuals.'
- ***Spot Taxis(Bangalore, India):*** This is the largest taxi franchise in Bangalore with 230 taxis. Each driver is able to own their own vehicles with a structured loan over a 3-4 year period. They all have in-car radios and are directed by a control room using a computer system which tracks their location. Some enterprising drivers now own more than one vehicle.

What is common about these projects? Each was started as a social VC business by an entrepreneur with the vision and the courage to take the risks. No aid was given. Funds were introduced into the businesses either as equity investments or as loans. The businesses operate in the mainstream and are run commercially. The employees understand that they are not working for a charity. Their long term employment is dependent on the success of the companies. Just as the Japanese FDI spawned new local entrepreneurs in Asia, so these projects expect to train and spawn the next generation of entrepreneurs in their countries.

And the cities of the developing countries are teeming with entrepreneurs who are creative, enthusiastic and resourceful. But like entrepreneurs everywhere they need access to capital and credit to start their businesses. C.K. Prahalad has also estimated that the market at the "bottom of the pyramid" (BOP), based on people living on less than \$2 a day, is worth \$13 trillion a year. Whilst he is encouraging the multinational firms to address this market, I believe it will be more effectively tackled by local entrepreneurs through their SMEs.

For social VC projects to succeed, several factors need to be present. There needs to be trusted and experienced local management in place. As with normal businesses, partnerships with other companies and institutions to secure technical expertise and additional management support are important. Partnerships also limit the risks of the businesses. Many of these social VC projects leverage local funding by acting as the lead investor syndicating other investors, soft loans and grants from government and development agencies.

This kind of financial leveraging further reduces risks. Local funding often only happens as matched funding when there is a demonstrable FDI in place. Local funding also means local ownership which further improves the chances of success for the business. In most cases, these businesses empower the management and employees with some ownership of their business.

The single biggest requirement for FDI is investor confidence in the macro-economic policy and stability of the country. Transparency, good governance and effective legal system are all necessities for attracting investments. However it is in this very area of creating an environment that fosters business start ups that the developing countries are the weakest. The World Bank's report *Doing Business in 2006*, shows that it takes 17 procedures and 165 days to start a business in Congo Democratic Republic compared with just 2 procedure and 2 days in Australia. For export of goods, it takes 16 documents and 60 days in Zambia compared with the 3 documents and 6 days in Denmark. Incredibly the export documents for Zambia require 25 different signatories. Still this is better than the record-breaking 45 signatories needed in the Congo Democratic Republic. This kind of inefficient bureaucracy encourages corruption and discourages entrepreneurship. In fact the World Bank suggests that future funding should be made "conditional on cutting the time and cost of business start-up." This proposal, using the research of Hernando de Soto, is designed to foster private enterprise. He contends for example that giving Africans secure title to their property would by itself triple the annual income of the whole continent.

### ***Call to Action***

My message is not to suspend aid but to restrict it, in agreement with Simon Jenkins. The message is that long term social transformation can only result when the poor are empowered with the self-determinism they want. And this can only come when they have employment that pays real wages for them to care for and educate their families. The action for western governments should be that a portion of their aid budget would now be channelled towards enterprise projects.

But social VC is a tough business. It requires business expertise and courage. It is riskier than a development project. Trying to get businesses going in the developed countries, with good access to capital and support infrastructures is difficult enough. It will be much tougher 'out there'. There will be failures. But even in failures, people learn new skills and diehard entrepreneurs will try again and again until they succeed. In the USA, they call those who have failed in a couple of ventures 'experienced'. Starting and running businesses require different kinds of skills to those present in the NGO community. Government funding for social enterprise should seek out the social VC organisations including the faith-based ones, to administer such funds for business ventures.

The task looks insurmountable. Individually we are so insignificant, so inadequate for the task. But as Lord Alton of Liverpool has said, 'Landslides happen when small stones begin to move'. Let us begin.

## **Bibliography**

1. 'Fifty Years of Failure' *Centre for Policy Studies*(1999) P. Bauer & C. Onslow
2. *United Nations Development Programme* (2003)
3. 'Time to Stop Fooling Ourselves about Foreign Aid' *Cato Institute* (2005) T. Dichter
4. 'Corruption and Foreign Aid in Africa' *Foreign Policy Research Institute* (2005) H. Werlin
5. 'World Bank Development Indicators' *World Bank* (2003)
6. 'Aid, Policies and Growth' *American Economic Review* (2000) C. Burnside & D. Dollar
7. 'New Data, New Doubts: A comment on Burnside and Dollar's "Aid, Policies, and Growth" (2000)' *Center for Global Development* (2003) W. Easterly, R. Levine & D. Roodman
8. 'Doing Business in 2006' *World Bank* (2005)
9. 'The Mystery of Capital' *Basic Books* (2000) H. de Soto
10. 'The Fortune at the Bottom of the Pyramid. Eradicating Poverty Through Profits' *Wharton School Publishing* (2004) C.K. Prahalad

About the Author

About TBN