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Agents of Transformation"*

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**DELIVERING EFFECTIVE FINANCING THROUGH PARTNERSHIP:
WORLD SANITATION FINANCING FACILITY (WSFF) – A NEW SYSTEMS
APPROACH: LESSONS FOR THE COMMONWEALTH**

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In February 2007, at the height of the boom, the *Financial Times* published a report by Moody's stating that the United States was in danger of losing its AAA rating as a result of healthcare and pension costs, compounded by growing demographic pressures. This was nothing new and reflected similar articles dating back to the 1980's, an issue policy makers in all G7 countries have consistently fudged.

2. What is not generally recognised is that after a lull of a few years these structural trends are now again about to worsen. Ironically, the US is actually the best placed among any G7 country.

3. Into this predictable chasm of political inaction, declining tax bases linked to growing domestic demands for health and pensions, and the global issues of Climate Change, Water and Sanitation, the storm of 2008 broke, and at a stroke has forced these issues onto the political agenda.

4. The growing mountain of government debt means that government is less capable of funding social programs, and for the first time since 1982 (with a blip in 1987/89) foundation funds have melted by over 35%, the effect further compounded in the US by the tax system. On the corporate side, corporate social funding (CSR) budgets seen by many CEO's as not core to their bottom line, are being cut back.

5. The situation indeed looks bleak. When you further realise that the current funding structure of philanthropy (or to phrase more cogently the supply of social capital) has really only two positions to invest: namely "a for profit" with social impact (say 6% plus); or a grant model where the money is given away (a return of negative 100%).

6. This system creates disincentives to scale or collaborate, no mechanism to scale an entity, and most importantly no mechanisms that encourage a systemic collaboration of players (for profit, not for profit, multilateral, governmental and corporate). Ironically and intuitively we all realize this collaboration is required to solve the complex social issues we face, but this is not how we currently finance or incentivize the players.

7. This reality is reflected in analysis published by McKinsey & Stanford highlighting the resultant effect, noting that in the US social capital market, the world's most sophisticated social capital market valued at \$1.4 trillion, less than 3.8% of the entities have revenues of larger than \$10 million. If you look back to 1973 less than 0.07% of all entities have managed to achieve revenues of \$50 million or more. The social capital market is in essence a huge market but one with very high degrees of fragmentation, with virtually no economies of scale. It is a market where the cost of allocating capital is estimated again by McKinsey to be 30 to 40 cents in the dollar (ten times the cost of the commercial sector). What does that tell you about the "Profitability" or to use the not for profit jargon, "*the sustainability*" of the whole sector?

8. The current legal and financial paradigm for philanthropy and development means there is:

- No mechanism to allow an idea in the not for profit world emerge effectively into sustainability, even cash flow is allocated by a grant model;
- Looked at as the R&D of society there is no mechanism that links this innovation to the down stream benefits (and cash flow) of its creation; and,
- No mechanism that allows a systemic collaboration of different players, for profit and not for profit.

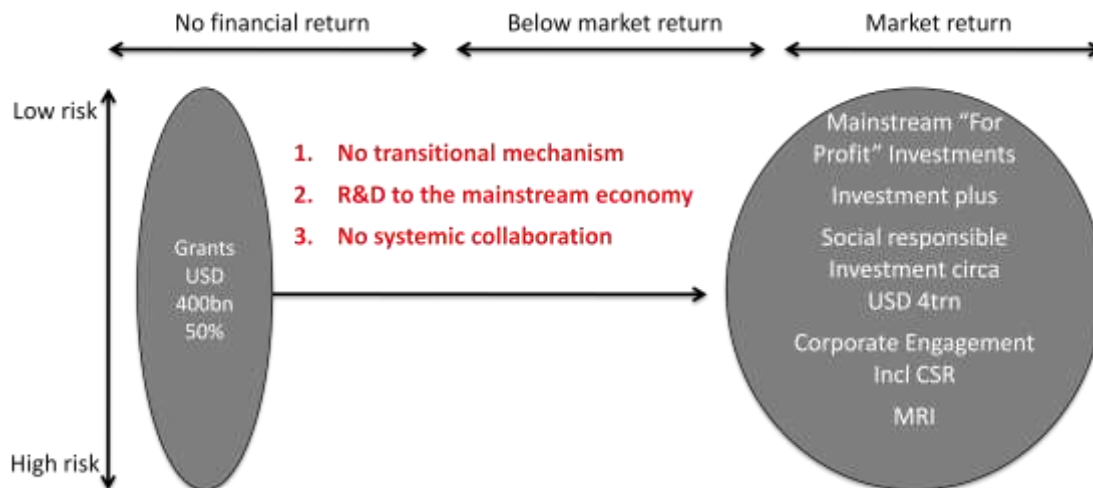


Figure 1: The Structural Funding Gap

The Need for a New Social Contract

9. However, it is this very inefficiency and scale that offers an opportunity to all parties by recognizing philanthropy has two roles in our society. One is charitable, and there are issues that will always require grant funds, issues such as immediate disaster aid, stopping child abuse or human rights. This should always be clearly supported, probably by grant.

10. Nonetheless, Philanthropy also performs another key function in our society, for which it is not always, fully recognized namely the Research & Development of Society: *the hub of new ideas*. Clear examples include the Agricultural Revolution pioneered by Rockefeller in the 1960's; more recently, the creation of micro finance. Indeed many things we see as charitable in the developing world are sustainable businesses in the developed world. The question is the time lag.

11. Faced with the fundamental question that there is simply not enough money in the current paradigm, and that we face the danger that we will fail, without wishing to sound too dramatic potentially as human kind, given the issues of climate and water, the question becomes quite simply: *how do we mobilize the resources of the whole of society, specifically the corporate and banking sector, to address these fundamental issues?* Maybe we should also pose the question: *why should it be*

somehow morally unethical to make money out of solving the fundamental issues of our time?

12. Indeed even from the perspective of the traditional not for profit world, why do we allow ourselves to be locked inside a legal and financial paradigm that ensures we do not benefit out of the downstream economic benefits of what we stimulate?

13. Ironically the philanthropic sector possesses huge strengths not only as the R&D of society, but also in terms of its access also to huge subsidies, both public and private. Structurally it is paradoxically the only large scale capital market where the participants will quite happily take a submarket return, indeed of negative 100%: a grant.

14. Despite the sector being a clear source of subsidy and ideas, the “for profit” corporate sector tends however to only cautiously engage in philanthropy, in two juxta-positioned ways. First, by not bringing their core skills to bear due to the fear of reputational risk and of being tabbed with “*profiting out of the poor*”. This school sees philanthropy as purely Corporate Social Responsibility, or at best a human resources concept, to which interest is usually higher in a bull market, not as a brand opportunity or as an opportunity to develop new markets.

15. Alternatively corporate practices can be viewed as more predatory, as can be seen in elements of the pharmaceutical world where the value of the R&D is extracted from the not for profit world in a grant model. The pharmaceutical company then separately benefits on the upstream distribution of those ideas and products in the for profit world, indeed for the most part the “*not for profit*” academics see themselves as lottery ticket winners, not as part of a consistent business proposition and act accordingly. The power is with distribution not innovation

16. Indeed the philanthropic sector is its own worst enemy as the legal and financial structure locks it in to the grant world and *dis-intermediates* the sector from the down stream benefits of what it does, so sacrificing influence and social mission as a function of the current funding process

17. Viewed as the R&D element of a broader societal pact to engage the "for profit" world in the interests of both parties raises some interesting issues:

- How do you ensure that the social mission is maintained and preserved?
- How do you create financial incentives for systemic collaborations?

18. Driven now by the finance crunch and in part by a growing realization by all parties that the current siloed paradigms cannot address the systemic failure in many social issues, compounded by the political and economic crisis of climate and water that can no longer be ignored, one is beginning to see change happening at a number of levels.

19. This is not just a cry of the citizens sector but as the former Canadian Prime Minister Paul Martin noted: “*Government unleashed the power of business entrepreneurs when it provided them with the wherewithal to succeed, with needed public goods and functioning capital markets.* What I would now ask, is that government unleash the power of social entrepreneurs as well by providing them with the wherewithal to succeed.”

20. At the local societal level the growth of social entrepreneurship and the broader growth of the Citizens sector reflects this desire to address at the level of the community the fundamental issues that government and the not for profit paradigm have clearly failed to address even in a time of benign economics

21. In the Private sector, foundation world the renewed interest in PRI (Program Related Investment – where a Foundation makes a loan as opposed to a grant) and MRI (where the core funds of a foundation are aligned with its social goals – i.e. Heron Foundation) as well as Social Investing, with new financing models and ideas emerging, all offer substantive promise and opportunity. It reflects the changes being fostered on that world by the cold light of economics. It reflects a need to move out of a paradigm that has only one funding structures, a foundation, which is a closed ended Investment trust. To one that asks: how can they leverage their capital for greater social impact?

22. It may help the reader to look at some of these new innovations with a more hawkish eye to impact and to put these innovations in a broader framework for action.

23. Reflecting this more hawkish view of philanthropy we can use the acronym TIERCEL (a hunting hawk) to identify some of this new innovation in scale:

- **T – Transparency** – Markets only grow with Transparency.
Inductive examples: work by Monitor, Rockefeller, Acumen (Pulse/PDMS)
Systemic Deductive examples: approaches include the McKinsey cost curve work.
- **I - Intermediaries** – The creation of new Intermediaries that middle the relationship between the sectors and the current silos to the benefit of the social sector stakeholders. Examples would include Lightyears SP in the Intellectual Property market and Environtrade as well as the Africa Forum in the carbon market.
- **E – Externalities** – Mechanisms that allow the valuations and monetization of the effects of investment in social funding. Examples where this is being considered include the Global Economics of Ecosystems and Biodiversity (TEEB) project in climate change (UNEP, UK, Deutsche Bank, UK and German Governments), SSFX.net in Peru and the Social Impact Bond (SIB) in the UK. This substantively changes the economics of a market. An example is that of Sanitation, the MDG Goal requires an estimated US\$85 billion of investment, which is how through a grant model it would be perceived. However with the social benefits monetised the market conservatively is potentially another US\$685 billion – creating a near trillion dollar market
- **R – Risk/Return** – Most players in the social sector assume this is unitary. However the creation of layered financial models with each player taking different social economic return allows more private capital to be injected into the market, so leveraging governmental capital. Examples include The US Affordable Housing Market, DFID Africa Fund, Deutsche Bank, IAPB, Ashoka Eye Fund among others.

- **C – Corporate Engagement** – looking into new models beyond CSR where philanthropy plays role in opening up new markets. Examples include DANONE and Grameen, Deutsche Bank Social Funds, Nike and Sport, JPM and their new Social Sector Finance Unit. Microsoft and P&G in new market development.
- **E – Entrepreneurship** – The Growth of Social Entrepreneurship and Social Enterprise models, innovation driven and owned by the community. Examples include Ashoka, Skoll, Echoing Green and Schwab.
- **L – Legal Structures** - A substantive growth in new legal structures to redefine the economic relationship between the social sector, government and the corporate sector such as the US Low Profit Limited Liability Company (L3C) and the UK Community Interest Company (CIC).
- **S – Scale** – The growth of mechanisms that drive substantive economies of Scale into the relationship between the social sector and corporate sector. Examples include the US\$3 billion Global Alliance for Vaccines and Immunisation (GAVI) initiative, which dropped unit cost of vaccinations from US\$50 to US\$5.

24. These new initiatives are driving substantive new capital and innovation into the philanthropic and social market place, but very much challenge the assumptions of the existing “not for profit” world. It creates not so much of a bi polar world of for profit and not for profit but one where philanthropy and social mission is part of a broader social contract to the benefit of all.

25. Practically the world looks begins to look more like the representation in figure 2: Collaborative Leverage instead of Grant and Silos.

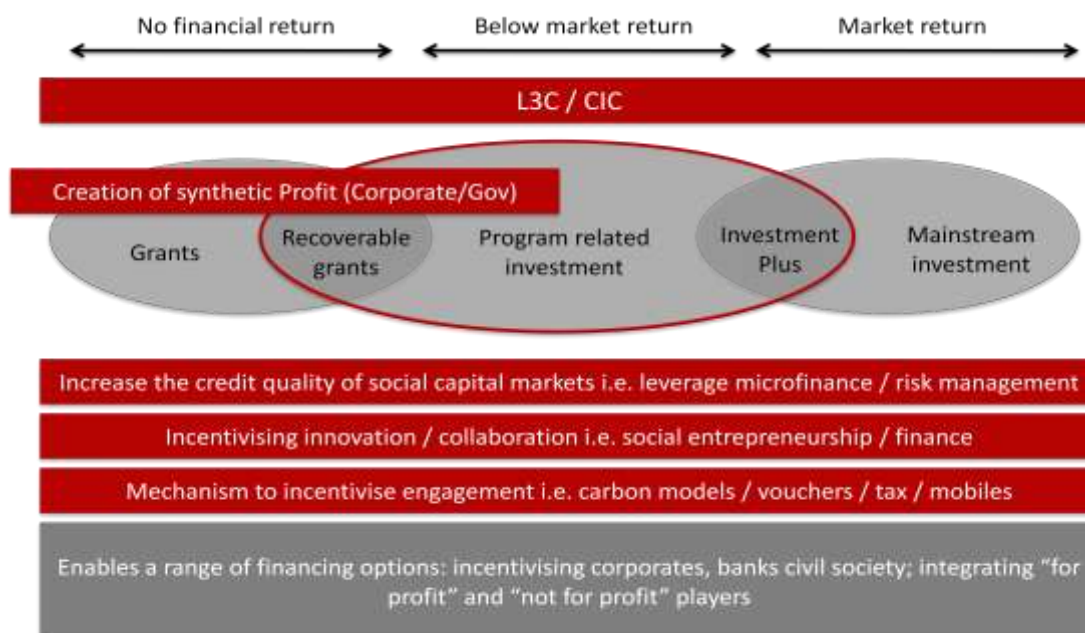


Figure 2: Adapted from "Foundations and Social Investment" Margaret Bolton 2005 and Bates Wells & Braithwaite

26. This leads to an interesting observation as to how as a global society do we marry the aspiration for systemic change as reflected in the stated desire to achieve the Millennium Development Goals to this new found individual innovation in philanthropy?

27. Indeed can one look at this in a systemic manner drawing this new innovation together to create the systemic solution or are we forever bound to the silos and assumptions in which we operate?

New Systemic Initiatives

28. The critical question then comes as to how to crystallize this systemic opportunity. One of specific opportunity lies in the World Sanitation Financing Facility (WSFF), a collaboration of nearly 30 key global players in Sanitation and philanthropy, including UNICEF, Water Supply and Sanitation Collaborative Council (WSSCC), WSP Group, Ashoka, Acumen, Keystone, IJ Partners, UBS Bank and McKinsey – each bringing a different core skill to bear.

29. The issue of Sanitation very practically impacts on the issue of gender discrimination. The issue is described by the leading medical journal the Lancet as “the most impactful issue in public health” and asks, “why do we not do more?” It impacts women most directly as the primary carers in the family as it is estimated that bad sanitation will cause ill health or kill an estimated 100 million children by 2030 – whilst at the same time ensuring that women – and it is women – who are forced to circumscribe their income earning or other activities since they spend up to four hours a day fetching unpolluted water. Ignoring the danger of assault as they defecate in the open, the discriminatory impact goes further with empirical evidence showing that young women who, as they reach puberty, also drop out of school if good sanitary facilities are not available.

30. Paradoxically, solving the Sanitation MDG actually contains a number of political, social and economic factors that make it ideal to prove a systemic solution. Those being:

- The Social and Economic Impact is beyond dispute, “*The most impactful intervention in Public Health*” (Lancet, BMJ) - it will kill circa 100 million children by 2025, but also impacts on the issues of Water, Women, Education;
- A single data set (WHO, UNICEF, WSP);
- A definable metric set and a potential audit mechanisms to crystallize the value of the social impact (WSP, Mc Kinsey);
- Valid Feedback mechanisms from the community (Keystone, SROI, Ashoka);
- You can actually identify the community engaged (UNICEF, WSSCC, GTZ, Ashoka, Acumen);
- A 7 Tier Business opportunity, US\$85 billion, but with an ROI of US\$685 billion, or on a macroeconomic basis equivalent to an estimated 2-7% of GNP of a range of developing countries - large enough to engage the interest of the commercial sector (WSP);

- Not a political zero sum game like water (Who does the water go to ?), but a major resource carbon and fertilizers with substantive social benefits;
- New Financial innovation capable of monetising these social benefits (New Social Finance tools)
- Given lack of resource the key status quo players recognise they have to look to innovation (Social Entrepreneurial and Social Finance) to draw new capital into the market;
- A mechanism to consolidate Social Sector innovation on a single platform focused on feedback from the Community (SROI, Keystone, Ashoka); and,
- The creation of Legal Financial mechanisms to create inter and intra Sector Collaboration with Social Objective so that the philanthropic subsidy is exactly that a leveraged subsidy for a philanthropic purpose (Legal Team – CIC/ L3C).

31. Not least of which is by identifying the Sanitation market through the prism of seven business lines which allows us to think of this as a \$3/4 trillion market place or, put another way, one that is costing developing governments between 2- 7% of GNP. Secondly one that moves the issue to one that recognizes development is not an issue for silos, as it is currently viewed much of the time - but that a key element of any philanthropic solution lies in incentivisation of other innovation and expertise

32. The WSFF is a group of (both top down and bottom up) the world's leading philanthropic organisations dedicated through using Sanitation to prove that a collaborative systemic approach is feasible and that as opposed to working within the current fragmented silos of development – multilateral, citizens sector and corporate - that we can create a new collaborative paradigm.

33. The business case reviewed and honed by McKinsey has been validated by all the partners of WSFF (primarily at EV and ED level) – including WSSCC, UNICEF and WSP on the multilateral side, and by Ashoka, SROI, and Keystone from the citizens sector - and other key stakeholders. The opportunity and prize for the partners of WSFF is the creation of a systemic solution for Sanitation – looking at Sanitation for the poor as a vibrant business opportunity, also capable of delivering employment locally and empowering women in those societies.

The Commonwealth's Potential Role

34. The current work being pursued by WSFF and McKinsey is the creation of a singular modular format capable of being applied and scaled across a range of countries and locations. The mechanism is capable of capturing the economies of scale of finance and the investment community that the corporate world, banks and investors can bring to bear. But - and it's an important point - one that equally recognizes that social objective has to be hardwired through legal and financial mechanisms into this engagement and that public and private subsidy has to have a clear development or social impact purpose.

35. This collaboration works best when juxtaposed with a process which recognizes that local innovation from social entrepreneurs – seen as the R&D of their society - and the ownership of the community and governments are fundamental and central to this process. Indeed, local stakeholders engagement as equal stakeholders in a single transparent platform which is financially inclusive is a model

for ensuring local communities benefit from the annuity income of developing businesses that also address societal need.

36. For donor governments – and indeed foundations - it reflects a new debate now in play – precipitated by the current financial crisis – where the question is now been asked by many donors as to how we leverage developmental capital away from just a tax and grant model.

37. Tax and grants will continue to be applicable for many issues for some time – however in many cases top down tax and grant structures do not create the cost structure, sustainability or incentive structure to collaborate.

38. The Commonwealth with its unique powers and culture is in a perfect position to help scale this model through its partners both governmental and civil society actors by doing what it does best – advocacy, brokerage and catalysing, in collaboration with the world’s leading philanthropic organisations. The strength of the Commonwealth lies in its unique collaborative structure – the core ethic of WSFF is creating structures to encourage collaboration.

39. This process recognizes what politicians of all ilk’s have been calling for the last four years on delivering effective development, that, **“our objectives cannot be achieved by government alone however well intentioned, or the private sector alone, however generous, or NGO’s or faith groups, however well meaning or determined. It can only be achieved in a genuine partnership together”**. This is the true bottom line.