Social finance: a new frontier for development in Indonesia

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Introduction

It is estimated that Asia Pacific countries face an annual development financing shortfall of about $44 billion. So if development challenges are to be tackled effectively, the slack in finances needs to be picked up by the private sector. This would bring market incentives for financial gain closer to public motivations for social good.

Social or innovative finance is a relatively new concept and refers to bringing capital or investment to enterprises that produce social and environmental benefits as well as financial profits.

The instant appeal of this approach is in the way it addresses inequality by helping the rich help the poor not as a form of charity but as an investment where everyone potentially wins. In so doing, it offers opportunities for grassroots initiatives to scale up their impact. It also potentially tackles gender inequality as women tend to participate and lead social enterprises.

The United Nations Development Programme (UNDP) is exploring this avenue and is inviting insights and partners to work on this relatively new endeavour.

Financing models

A number of new financing models are emerging both in terms of their market size, their operations, and the way they serve those in developing countries, as a financing alternative.

These models range from equity-based crowdfunding and P2P (peer to peer) to alternative currencies, smart remittances, impact investment, payment for results and mobile money which can provide some of the solution to address a financing gap faced by many governments in providing basic services. By 2025, World Bank estimates suggest that crowdfunding could reach $96 billion.

Of particular importance for the Asia Pacific region is the growth of private monies. According to the Asian Development Bank, for Asia Pacific as a whole, the bulk of funds are now in private hands, in the form of remittances, foreign direct investment flows and private savings. And by 2030, Asian equity markets will represent around 42 per cent of global market capitalization, and up to 72 per cent by 2050.

J.P. Morgan and Global Impact Investing Network research indicates that the 157 leading impact investing organisations committed $15 billion in 7,551 impact investments in 2015, with significant growth expected in 2016, including in Asian markets.

Opportunities for Indonesia

Take Indonesia for example, which by several measures, is a formidable nation. It is the fourth most populous country in the world, with the tenth largest economy according to purchasing power parity, and it is a member of the G-20. Despite that considerable economic progress, it continues to face development challenges: persistent poverty, inequality, and environmental degradation.

The question then arises as to how the country can channel its economic might to meet those development challenges.

The Financing for Development Conference held in Addis Ababa last year confirmed that as Overseas Development Aid declines – particularly in middle-income countries, such as Indonesia – domestic resources are critical for solving development challenges. While the government can and does commit resources, that alone is not enough.

A mindset shift is already underway. In 2007, with the promulgation of Law No. 40 on Limited Liability Companies, Indonesia was the first country to adopt mandatory Corporate Social Responsibility. More companies now adhere to stricter social and environmental standards. Regional banks, such as Bank Nusa Tenggara Timur, with whom UNDP recently entered into partnership, are experimenting with offering collateral free loans to the poor and providing infrastructure support, including access to clean water.

A social finance ecosystem is emerging in Indonesia and UNDP wants to support its growth. Indonesia's nascent but growing social enterprise sector includes more than 450 social enterprises with a further 1000 aspiring to become social enterprises, according to the Boston Consulting Group's report 'The Art of Sustainable Giving'. These are young start-up social enterprises that want to make a difference as well as make money.

A number of social impact investors have emerged in Indonesia whose function is to prepare social enterprises and then link them to financial investment. But the verdict is still out on which modalities are most appropriate and suited to the Indonesian context.

Experience from UNDP's Local Economic Development in Papua shows that over a three-year period, businesses in honey, coconut oil, organic fertilizer and nutmeg syrup were incubated and incomes increased but further capacity building and better access to markets are needed to sustain and expand these businesses if they are to become investment opportunities.

UNDP in Indonesia is diversifying its partnership base and working with the private and financial sectors, as well as government and traditional development partners. Earlier this year for example, UNDP signed a partnership with OJK, Indonesia's financial authority, signalling our joint intention to find pathways for financial inclusion of the poorest segments of the population.

Next steps for the UNDP

Social finance is a new arena for UNDP and at this initial stage, we are talking to various players to help identify gaps and a possible useful contribution. Some areas where UNDP could potentially support social finance and social enterprise include:

1. **Connector** and broker of partnerships between national and local levels and between different actors including government, ensuring information is shared between stakeholders
2. **Policy advisor** to the government on role of social impact investment and making the regulatory environment conducive
3. **Quality assuror** to investors, bringing tools and knowledge on social and environment safeguards and local context
4. **Development of pipeline of initiatives** that offer environment and social benefits in poor regions to become investment ready
5. **Ensuring quality design** of entrepreneurial initiatives through introduction of innovations and scaling strategies

Through engaging on social finance, it is hoped that we can contribute to Indonesia becoming a country where social enterprise can thrive and in turn, help alleviate poverty and inequality and improve Indonesia's rich biodiversity and environment.

We welcome any comments or feedback from readers on this blog and look forward to updating you on how this work progresses.

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Notes:

- *The post gives the views of its authors, not the position of LSE Business Review or the London School of Economics.*
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