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The Finance Sector and the Social and Solidarity Economy

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Abstract

The entry explains the contribution of the social and solidarity economy (SSE) to strengthening social control over the finance sector for sustainable development. It highlights the role of SSE in developing financing mechanisms for the socio-economic development of deprived areas and vulnerable groups of people. It particularly pays attention to the SSE sector to provide long-term patient capital for local economic development and to the characteristics of SSE in the finance sector in comparison with for-profit financial institutions. The entry introduces diverse forms of SSEOEs and enterprises (SSEOEs) in the finance sector and their contributions to sustainable development.

Keywords

cooperative bank; ethical bank; social lending; crowdfunding; grant-making foundation; mutual insurance; mutual funds

Introduction

A defining feature of the social and solidarity economy (SSE) is its bottom-up nature: SSE organizations and enterprises (SSEOEs)arise when groups of citizens seek to collectively provide answers to their needs or to the needs of their community. These needs can be of various kinds, including self-employment, access to consumer goods, provision of social services, organization of cultural activities, marketing of agricultural or other products, and so forth. One of the needs that has historically been at the root of many SSE initiatives is the need for financial resources. Indeed, finance plays a key role in the life of both individuals (to manage savings and investments and to access credit for a variety of purposes) and organizations (to cover start-up costs, to address cash flow issues, to fund investments, and so forth), and is thus a fundamental ingredient in the process of economic development. It is not surprising, then, that people have sought to devise collective solutions to this shared need, often pooling whatever economic means they had access to in order to supply financial resources to the members of their community.

As in many instances when it comes to SSEOEs, the specific organizational forms through which this happened have varied greatly based on different cultural and legal contexts and ranged from small and informal arrangements to large, highly formal, and structured organizations. At the small and informal end of the spectrum, for instance, forms of rotating savings and credit schemes based on mutual aid principles can be found in many African countries and have been around for centuries: the *abota* in Guinea-Bissau, the *tontine* in Morocco, the *iqqub* in Ethiopia are just a few examples of ways in which local communities have sought to address the issue of access to finance. At the other end of the spectrum, we find formal and structured organizations like cooperative banks and mutual insurance companies, some of which have grown to be among the largest financial institutions in the world. In general, there is a great variety of SSEOEs that operate within the boundaries of the financial sector, providing financial products and services of various kinds to individuals, other SSEOEs, as well as public sector agencies and for-profit businesses.

These organizations have often been instrumental in the economic development of their communities, in some instances contributing to lifting entire regions out of poverty by making investments possible where other actors were unwilling or unable to operate. Their ownership and governance structure ensure that the primary focus of the organization is serving its members and community, and their close ties with the community itself enable relationship lending practices that help better evaluate risk and serve customers that would otherwise be excluded from the market.

This entry will focus primarily on the main actors in terms of structure and size, reviewing the different types of SSEOEs that supply financial resources through the various financial mechanisms (see the entry “Financing for SSE”). Since one of the ways in which financial resources can be made available is grants and donations, this entry also includes philanthropic organizations. These organizations are not usually considered part of the financial sector because they are not market actors, but they are an important part of the SSE and play a key role in making financial resources available to other SSEOEs. It should also be noted that this entry focuses on SSE entities providing financial products and services. There exist also public sector entities that are mandated to support the financing of SSE, usually in partnership with SSE actors (see the entry “Supporting organizations and intermediaries for SSE”.

1. The SSE in the finance sector

The main types of SSEOEss operating in the finance sector are presented below. They are classified based on the type of activity or financial products they provide: grants, banking services (including debit), risk capital (equity or quasi-equity), guarantees and insurance.

1.1 Grants

The primary actors within the SSE providing grants (i.e. financial resources that do not need to be repaid) are foundations. Foundations are legal entities created to achieve specific goals related to the wellbeing of target groups of people or communities through the use of an endowment or systematic fundraising (EURICSE 2013). Foundations pursue their goals in a variety of ways, including through the direct supply of services. This entry focuses on grant-making foundations, i.e. foundations that use their endowment or the funds they raise to fund projects or activities carried out primarily by other SSEOEs, or in some instances to fund the organizations themselves in order to help them grow and increase their impact. There are three basic types of grant-making foundations:

- Individual or family foundations, founded and endowed by an individual or a family, usually in support of a specific cause
- Corporate foundations, founded and endowed by a company as a form of corporate social responsibility strategy
- Community foundations, founded by a plurality of actors from a specific geographical area, usually with the goal of raising funds in support of the local community and economic development initiatives

In addition to these three, which are the most common, in some countries, there have also been instances of foundations arising from the privatization of state-owned enterprises, as in the case of banking foundations in Italy. Regardless of their origin, foundations typically invest their assets in equity and bond markets and use dividends and the payment of interest to issue grants that further their social mission. While grant-making is by far the most prevalent way in which foundations make resources available to SSEOEs, it should be noted that it is not the only one. For instance, through program-related investment (PRI), part of the endowment of the foundation consists in the investment in social enterprises expecting a repayment with some interest, albeit usually at below-market rates. Recently, forms and instruments of “venture philanthropy” have begun to emerge, combining a customized financing strategy with non-financial services, organizational capacity-building and performance measurement by applying risk capital techniques to the grant-making activity in favour of social enterprises. These funds typically provide grants, equity investments, or debt instruments that require an economic performance as well as the expected social return (ILO 2019).

Unlike other SSEOEs, foundations do not have a democratic governance system. However, the use of their endowment is tied to the statutory purposes of the organization and the assets cannot be appropriated by the founding or governing parties, ensuring their adherence to their mission.

1.2 Banking services

SSEOEs have been present in the banking sector for almost 200 years, ever since the first cooperative banks were founded in Germany in the mid-nineteenth century, first by Schulze-Delitzsch (primarily in urban centres and geared toward the needs of artisans and shop owners) and then by Friedrich Raiffeisen (mostly in rural areas and addressing the needs for capital of small farmers). From those early experiences stem the two main types of banks based on cooperative principles that are still prevalent today: (1) people's banks, deriving from the work of Schulze-Delitzsch, and (2) cooperative banks, based on the model developed by Friedrich Raiffeisen.

While there are significant differences between the two models, in both instances the banks are owned by their customers and are based on mutualistic principles. They both originated by people pooling their assets through unlimited liability schemes (i.e. the legal obligation of company founders and owners to repay, in full, the debt and other financial obligations of the company) in order to leverage enough capital to start the bank. And while at the beginning the bank's business was primarily with its members and limited to the economic activities that characterized them (artisanry and trade in one instance, agriculture in the other), over time both models diversified their customer/membership base and started serving the entire population of their areas of operation. They also increasingly served non-members as well as members, shifting from a strictly mutualistic logic to a role as banks for the community at large, whose primary function became ensuring the economic development of their areas of operation.

The main difference between the two models today is that people's banks also issue stocks that are traded on public stock markets, and as such are partly owned by non-members, diluting member control on the bank's governance. They also tend to be larger institutions with weaker ties to their local community. Cooperative banks on the other hand adhere to the one member-one vote cooperative principle, tend to be smaller in size (even though they can join together to form very large banking groups, as described below) and are more rooted in their geographic area of operations.

In addition to these two types, there are other SSE banks that are based on cooperative principles, such as building societies, mutual savings banks, etc. Among these, credit unions and ethical banks are of particular significance. Credit unions are in all respects cooperative banks, but have some specificities: their members usually have something in common, e.g. the same employer or profession, they are often funded only by members' deposits avoiding outside borrowing, and in some countries, they are restricted to providing only personal loans. They tend to be smaller in size, although in some instances can also grow very large (as in the case of the Navy Federal Credit Union in the United States, for instance, which has a banking income of over 6.5 billion US$).

Ethical banks also adhere to cooperative principles but have a specific focus on supporting social and solidarity initiatives and sustainable economic development. Through their lending and investment practises, ethical banks support companies and projects that have a high social or environmental value, responding to the needs of people excluded from the banking system, or of people who seek to achieve a positive social impact through their savings and investments. Ethical banks originated in Europe approximately 30 years ago and work closely with other cooperative banks in various ways, including for the sale of their social investment products.

Cooperative banks can be found all over the world, and in some instances have grown to be major financial institutions, primarily by joining together to form cooperative banking groups: from the *Mouvement Desjardins* in Quebec to the *Crédit Agricole* and *Crédit Mutuel* in France, from *Rabobank* in the Netherlands to ICCREA and *Cassa Centrale Banca* in Italy, from CBK in Kenya to *Sicredi* in Brazil, cooperative banks have become major players in the financial sector in their respective countries and are consistently among the largest cooperatives in the world (EURICSE and ICA 2021).

At the same time, there is ample evidence that their specificities in terms of governance and objectives (namely, addressing the need for credit of their members/customers rather than generating value for shareholders) result in significant differences in behaviour relative to commercial banks. They have been shown to be consistently more risk-averse than commercial banks, avoiding investment in riskier and more speculative financial products and adopting instead a longer-term approach to financial sustainability. As a result, they tend to be more capitalized and resilient than commercial banks in times of crisis (Birchall 2013). They have also played, and continued to play, a key role in the economic development of their communities, often operating in areas that are neglected or ignored by other types of financial institutions.

1.3 Equity or quasi-equity investments and patient capital

Equity investments are typically the domain of mainstream financial institutions, as they primarily follow a profit maximization logic that is not in line with SSE objectives. However, over the years the SSE has given rise to its own sources of equity capital in order to address the needs of SSEOEs. Indeed, while SSEOEs can meet many of their financial needs through access to credit from the banking system, sometimes they also require equity capital to fund investments. Given their specificities, SSEOEs are ill-equipped to access the same sources of risk capital as for-profit companies: unlike shareholder companies, they are not designed to remunerate investors, and their democratic governance structures make it difficult to assign decision-making powers to those who bring capital to the firm (see the entry "Participation, governance, collective action, democracy and SSE"). For these reasons, SSEOEs in need of capitalization have looked primarily to their own membership base through a variety of schemes (see the entry "Financing for SSE")and to the accumulation of surpluses over time.

In some cases, though, particularly in contexts with a very well-developed SSE ecosystem (see the entry "Institutional ecosystem for SSE"), new SSE institutions have been created for these purposes. This is the case, for instance, of cooperative mutual funds in countries like Italy, where cooperatives are required by law to destine at least 3% of their surpluses to national or regional funds that are then used to support the development of the cooperative movement in a variety of ways, including through investments. In other contexts, the interaction between the SSE ecosystem and the public sector has given rise to a variety of financial instruments largely controlled by the SSEOEs and available to SSEOEs. In Italy, for instance, the cooperative movement and the public sector contributed to the creation of CFI (Cooperazione Finanza Impresa), a financial institution devoted to investing in worker and social cooperatives in order to help their start-up phase, including in the case of worker buyouts or business transfers to employees. It is also the case of Quebec, for instance, where the co-design of policies by SSEOEs and local government has led to the creation of initiatives like RISQ and the *Fiducie du Chantier de l'économie sociale*, which provide several financial products including patient capital to support social economy enterprises at every stage of their development

(see the entries “Supporting organizations and intermediaries for SSE”, “ Partnership and co-construction and SSE” and “Partnership and co-construction and SSE”)(McMullin 2021)

1.4 Guarantees

Risk evaluation on the part of financial institutions can sometimes be more challenging for SSEOEs relative to for-profit enterprises, due to a variety of reasons including the lack of standardized data to assess creditworthiness. Moreover, SSEOEs sometimes do not have significant assets that can be used as collateral in order to access credit. As a result, one of the main hurdles facing SSEOEs in accessing financial resources (whether from cooperative banks or other types of non-SSE financial institutions) is the availability of guarantees.

As in the case of equity capital, SSEOEs have developed their own solutions to this issue, primarily through the creation of guarantee consortia. The guarantee consortium assesses the creditworthiness of the guaranteed company together with the bank. The guarantees provided by the consortium are based mainly on special money deposits established with the affiliated banks, which are meant to cover any potential loss. In the case of guarantee mutual funds (GMF), the assets that are used to make commitments to the banks are constituted by the contributions of the individual SSEOEs that might make use of it. The member companies constitute a financial asset allowing them to make commitments towards the banking system at more advantageous conditions. In some instances, public contributions might then increase the assets available to the GMF (even sometimes with the role of ultimate guarantor or “counter-guarantee). In comparison, credit surety funds (CSFs) are generated by a broader range of contributors, such as well-capitalized cooperatives, local government units, government financial institutions, industrial guarantee and loan funds and other institutions/government agencies. The beneficiaries of the CSFs are not restricted to the contributors, since the mutualistic principle is not required. Micro, small and medium enterprises, as well as cooperatives and other SSEOEs, might be guaranteed to have easier access to credit from banks despite lack of collateral, regardless of whether or not they contributed to the CSFs (ILO 2019).

1.5 Investment insurance

The final type of SSEOEs providing financial products are mutual insurance companies. Mutual insurance companies originated in England in the 17th century to cover losses due to fires, and spread from there throughout Europe and beyond, expanding over time the range of risks they covered and the insurance products they offered.

Mutuals are insurance companies owned by the policyholders, which select the management of the company. Their primary goal is to provide their members with insurance coverage at the lowest price, making it more accessible. Profits are usually distributed to the members via a dividend payment or a reduction in premiums. Since they are not traded on stock exchanges, they do not have to reach short-term profit targets and thus can invest in safer assets and pursue long-term goals in the interest of their members. Mutual insurance companies can be found all over the world, and according to the International Cooperative and Mutual Insurance Federation (ICMIF), mutual or cooperative insurers serve more than 900 million people worldwide. As in the case of cooperative banks, mutual insurance can be very large organizations: in Japan Nippon

Life, the largest mutual in the world, has over 90,000 employees and a premium income of over 50 billion US$.

Mutual insurance companies are included in this entry because, as most insurance companies, they also supply financial products to their members: they manage savings and investments, provide retirement plans through pension funds, and offer financial insurance policies (primarily for life insurance) for which the amounts of benefits offered are tied to the performance of an underlying investment asset.

Conclusion

The SSE is best understood as an alternative way to organize economic activity. SSEOEs can be found in every sector of the economy operating according to a different logic than for-profit companies, and the financial services sector is no exception. While by no means exhaustive, the list of organization types presented above accounts for the main ways in which the SSEOEs operate in this sector, and is sufficiently complete to draw some cross-cutting observations on the specificities of SSEOEs within the broader landscape of financial service providers and on the implications of these specificities in terms of the role and relevance of the SSE in the financial sector and beyond.

The ownership and governance structure of SSEOEs make a big difference in terms of the goals of the organization and ultimately in terms of its behaviour on the market. All of the SSEOEs described in this entry (with the exception of foundations) are owned by their customers, and their goal is thus not to maximize profits (although they of course need to be profitable in order to stay on the market) but to provide financial products to their members at the best conditions possible. Democratic member control on the governance of the organization helps ensure that management responds to member needs, and that the organization's strategies are consistent with their long-term interests.

This in turn determines significant differences in the ways in which these organizations behave on the market relative to their for-profit counterparts. First, they tend to be more risk-averse, adopting long-term investment strategies and shying away from more speculative financial products. This behaviour for the most part has shielded SSE financial institutions from investment bubbles and ensuing financial crises, including most notably the 2008 financial crisis tied to subprime lending. Indeed, not only did cooperative banks avoid selling subprime loans to their customers, but they also by and large did not invest in the derivative financial products that were tied to those loans. As a result, they did not need to be bailed out by governments after the market crashed and were the only banks that continued to lend money during the ensuing credit crunch, playing a key role in supporting the local economy. Moreover, due to their profit distribution constraints, they tend to be more capitalized than commercial banks, which also contributes to their resiliency.

Another notable difference in behaviour concerns the areas in which these organizations operate and the people they serve. From their origins forward, they have been particularly adept at serving the financial needs of people and firms that would otherwise be excluded from the financial market. By having a close and direct relationship with their members/customers, they are often better able to evaluate risk compared to standardized credit scoring systems, which enables them to be more inclusive in their lending practices. Similarly, they have traditionally operated also in areas where other banks have not been able to, sometimes as the only financial institution serving the community. As a result,

they have played and continue to play an instrumental role in the economic development of rural and underserved communities.

This does not mean that they are necessarily small and marginal. As we have seen, in many cases they are major players in the market, reaching millions of customers and managing very large assets and funds. In Europe, for instance, cooperative banks have a market share of over 20% for both loans and deposits (Groeneveld 2019), and mutual insurance companies are among the largest insurance companies in many countries across four continents. Moreover, SSE financial organizations have found ways to serve the needs of people, businesses (primarily small and medium-size enterprises) as well as other SSEOEs, displaying the same dynamism and versatility that characterizes the SSE overall.

Moving forward, the ability to provide financial resources that are consistent with the specificities of SSEOEs will be increasingly important. Indeed, over the last few years, SSEOEs have started engaging in more capital-intensive activities such as urban renewal, waste management, management of facilities for cultural activities, cultural heritage management, social housing, and others, and this engagement is expected to increase in the near future. This evolution is likely to increase demand for finance, beyond what has been made available so far.

At the same time, the evolution of the financial services sector linked primarily to the advent of information and communication technologies is giving rise to new ways to make financial resources available to individuals and businesses alike, often based on the use of new IT platforms connecting them directly to prospective donors, lenders or investors. This is the case, for instance, of new crowdfunding and crowdlending platforms, in some cases targeted specifically to SSEOEs. Many of these platforms are set up as for-profit companies, but the SSE could play (and in some cases is already playing) a role in this space as well (see the entry "Information and Communication Technology (ICT) and SSE").

In general, the scales of intervention called for by the change in our societies requires equipment of SSEOEs with new models and new tools that are capable of coping with a more massive demand for goods and services. From a financial perspective, this means the development of an adequate and accessible supply with a blended approach, mixing different tools and strategies, consistent with the specificities of SSEOEs. Based on the history of the SSE, a significant portion of these resources and tools will likely come from within the SSE itself, expanding the reach and diversity of SSEOEs operating within the financial services sector. At the same time, this should be complemented with well-crafted long-term public policies, co-constructed with SSE actors, to support the growth of SSE financial ecosystems, in terms of SSE-adapted regulatory frameworks, institutional support and resources.

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