A SWISS SOCIAL STOCK EXCHANGE TO CONNECT SOCIAL ENTERPRISES AND IMPACT INVESTORS

Executive summary

Geneva, December 2018

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PREAMBLE

In 2015, Sustainable Finance Geneva (SFG) initiated a project to assess the rationale, feasibility, and business case for creating a Swiss Social Stock Exchange (SWISOX).

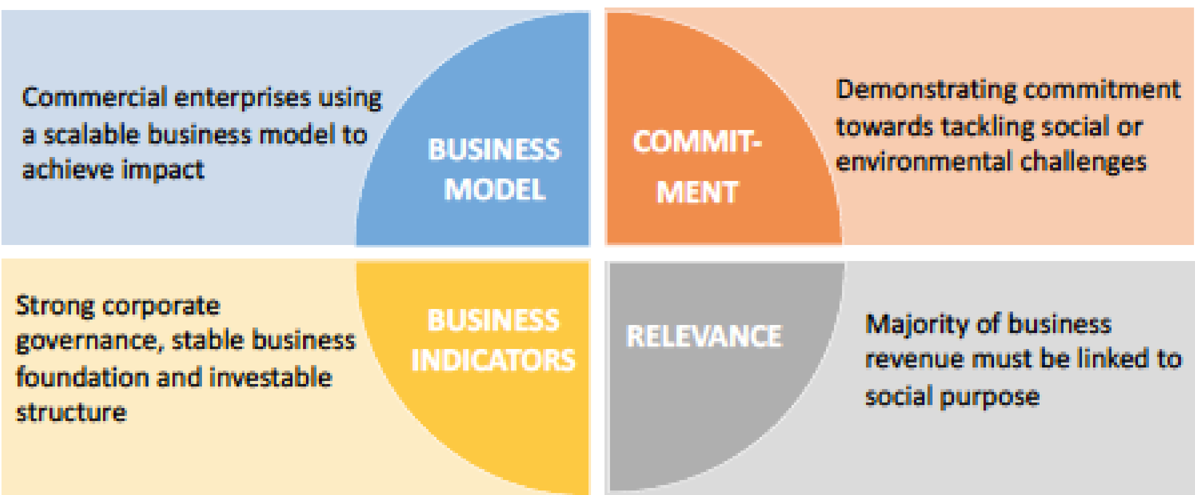
Following a preliminary high-level market assessment, SFG engaged iGravity, an advisory firm specialized in impact investment and innovative finance solutions, to conduct a detailed feasibility study of the project. This study has been made possible as a result of the support and generous contribution from **Fonds Nationale Suisse de la Recherche Scientifique**. The following presents the summary findings and key takeaways of the study, which was conducted between April and December 2018.

1- Social enterprises and the potential financing gap

1.1 What are social enterprises?

While there is no globally accepted definition of what a social enterprise is, most scholars and practitioners agree that social enterprises are organizations that combine a social or environmental purpose (typically aligned with the United Nations Sustainable Development Goals – UN SDGs) with the pursuit of financial success. Definitions differ across the board and mainly revolve around the legal form, the use of proceeds, and the mission statement.
There is also a distinction between a social enterprise and a socially responsible business. The former explicitly states its social mission in its documents of incorporation, is founded on the basis of achieving a specific social or environmental mission, and seeks to reinvest a portion of its profits rather than full distribution to shareholders. The latter primarily seeks to maximize profits, but tries to reduce the negative externalities its operating model might have on the planet and society. Therefore, the element of intentionality of a social enterprise becomes a distinguishing factor.

The study concludes that there is limited value in developing an additional definition of social enterprises, and rather proposes a framework with which to assess the eligibility of enterprises for a potential social stock exchange:



1.2 Social enterprises: market sizing

With the general definition in mind, and based on available small- and medium-sized enterprise (SME) data from the International Finance Corporation (IFC) and other regional and country reports, the study estimates the total number of medium-sized social enterprises to be at least 14,000 in the U.S., Canada and Europe alone.

Like traditional enterprises, social enterprises face many operating constraints, most pressing of which are financing constraints. Statistics from the European Commission on financing needs for SMEs were used to calculate the aggregate financing needs of the aforementioned 14,000 social enterprises, which was extrapolated to be around CHF 13 billion.

2- Impact investing and the pursuit of the double-bottom line

Impact investors are clearly defined as investors seeking both a financial and social return from their investments. Impact investors would typically invest in social enterprises that would be eligible and potentially listed on SWISOX. The Global Impact Investing Network's (GIIN) Annual Report of 2018 estimates global impact investments at approximately CHF 400 billion. Driven by increasing investor demand, and rising awareness of the need to tackle pressing societal issues, the impact investing market is growing at more than 20% annually. Applying past compounded annual growth rates, the estimated global market size in 2025 could reach up to CHF 600 billion.

While the impact investment market is growing, hurdles still prevent it from becoming mainstream, including, the sourcing and evaluation of deals, deal sizes, viable exit options, and impact measurement.

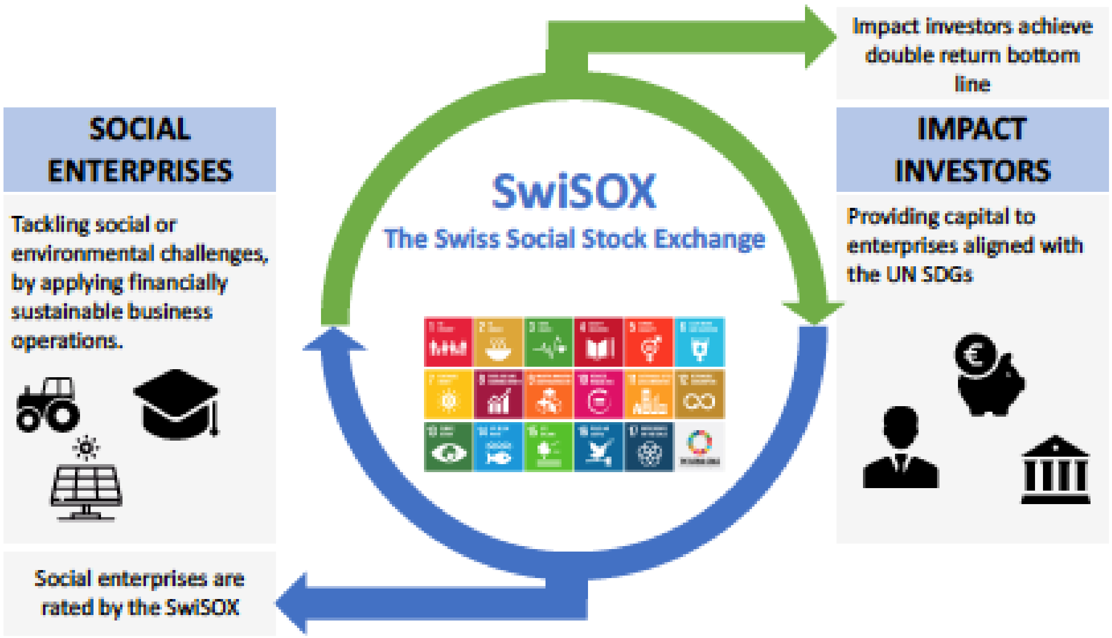
More potently, impact investors are actively seeking solid investment opportunities; and social enterprises are actively seeking new and additional sources of funding.

3- The case for a social stock exchange

Stock exchanges basically serve as primary markets where corporations, governments, municipalities, and other incorporated bodies can raise capital by channeling investor capital into productive ventures and projects as well as secondary markets where investors can sell their securities to other investors for cash, thus reducing the risk of investment and maintaining liquidity in the system. While financing is at the heart of what exchanges do, stock exchanges have also historically played a strong role in the development of capital market institutions, standards, and corporate practices. Furthermore, stock exchanges increase transparency in financial markets by bringing together a large and diverse set of investors and reduce the size of an individual investment.

In the past 15 years, the number of stock exchanges serving the needs of SMEs has almost doubled to currently 54 exchanges around the globe listing approximately 10,000 SMEs. International initiatives, such as the UN Sustainable Stock Exchange Initiative, are bringing sustainability issues to the agendas of stock exchanges. However, most of the initiatives focus on ESG (environmental, social, and governance) matters and do not include standards or mandatory practices around impact measurement.

Social enterprises are taking off as a new operating model addressing acute societal challenges that have gained a global consensus through the UN SDGs. With the large and growing market of medium-sized social enterprises globally and their significant lack of access to financing, coupled with a strong and growing trend in impact investments, there lies an ideal opportunity for the SWISOX.



4- Lessons learned from social finance platforms

4.1 A stock exchange or a platform?

It is important to highlight the differences between a stock exchange and a platform. In this context, a stock exchange refers to a fully-fledged stock exchange, which is regulated by a national financial authority, allows access to all kind of investors, and covers all or most of the different parts of a stock exchange value chain. A platform refers to an electronic meeting place, where investors and investees can meet, connect and agree to exchange capital and securities at a specific price. The platform may or may not offer additional services, but at the core there is a closed-end user group that registers on a marketplace upon fulfilling a number of requirements to interact with enterprises and agree to transact.

Regarding platforms, there is a difference between investor-project matching and one-sided transaction platforms. Whereas the latter only facilitates the flow of investment or donations to enterprises or projects deemed socially valuable by the platform, the former also usually offers additional services, such as classification and vetting criteria.

There existed or still exists today multiple social finance platforms that have connected social enterprises and non-profit organizations with potential investors and donors. A survey conducted by the Bertelsmann Foundation concludes that most of these platforms are either small-scale, donation-orientated, or very specific to their target group or geographies.

4.2 Lessons learned from early attempts of a social stock exchange

The study identified and focused on three relevant self-labelled social stock exchanges that have existed or are still existing today:

1. **The Social Stock Exchange (UK-SSE)** was launched in the UK in 2009. Instead of a stand-alone platform, the UK-SSE was established as a platform partner of the NEX exchange in the UK (NEXGY) that focuses on electronic trading. The partnership with NEXGY meant that UK-SSE would begin by cross-listing companies with the NEXGY, and would ultimately work towards encouraging social enterprises to undergo an initial public offering (IPO) on their platform. However, this initiative was not able to find a viable economic model and, the partnership with NEXGY was dissolved in late 2017 and the UK-SSE was shutdown.

2. **The Social Venture Conexion (SVX)** was launched in Canada in 2009. Currently the platform operates as an investor-project matching platform. It does not completely qualify as a social stock exchange yet, as it does not offer a secondary market for investor-to-investor trading. However, based on interviews with SVX management, there are plans to establish a secondary market in the near future. In partnership with the Toronto Stock Exchange (TMX Group Inc.), SVX is set up as an non-profit organization that targets self-sustainability. SVX's core technology, Katipult, is a white-label crowdfunding platform open to both retail and qualified investors through which both investors and issuers can manage their investments on the platform. SVX outsources much of their impact criteria to the Canadian B Corporation standards. They do not explicitly require every issuer to be a registered B Corp, but they do require issuers to achieve a minimum score of 80 on the B Impact Assessment.

3. **Impact Exchange (IIX)** was launched in Singapore in 2009. It was originally envisioned as a true stock exchange that would list and trade bonds, shares, and securities with a social purpose. Due to legal constraints, it pivoted its operating model to become an investor-project matching platform and has since established a partnership with the Stock Exchange of Mauritius Ltd (SEM) to set up listing rules and ongoing listing operations, though no listing has been completed to date. Since its establishment, IIX has mobilized more than CHF 13 million in capital through its private placement platform for equity and debt funding, working only with accredited investors. The exchange does not host active listings but does screen impact enterprises using proprietary criteria.

Key lessons learnt from the existing social financing exchanges-cum-platforms include the need for a robust revenue generation model, the need for attracting and maintaining a strong pipeline of issuers, the ability to maintain market liquidity, and the necessity for a neutral, consistent and non-binary impact measurement scoring tool that can provide cross-sectorial comparability. Moreover, it is important to partner with an existing infrastructure in order to avoid significant costs of establishing a stand-alone exchange. In surveying stock exchanges' operating models, it is equally important to maintain a lean operating model to handle technical and compliance roles, and rely on scalable software that can accompany the evolution of the business.

5- SWISOX value proposition

5.1 Additionality

Based on the lessons learned from the early attempts, to effectively link social enterprises with impact investors, the value proposition of the SWISOX needs to present a differentiated model that provides additionality across five main aspects that are currently not, or poorly addressed, by existing solutions:

1- **Impact methodology:** No platform offers a comprehensive methodology to assess an investment's impact.
2- **Scalability:** Limited deal sizes were identified as one of the main constraints regarding impact investments. Most of the evaluated offerings were also not able to mobilize enough deal flow.
3- **Liquidity:** Dedicated market makers creating liquidity are standard for every big stock exchange. However, for smaller platforms or platforms dedicated to social enterprises, this was one of the major challenges.
4- **Additionality:** Most offerings have not been able to create real additionality for investors and enterprises.
5- **Regulation:** With the exception of traditional and some major SME stock exchanges, platforms lack strong, comparable regulations, which can result in insufficient liquidity and thereby scare off institutional investors.

The potential offering of SWISOX should be based on the above identified gaps.

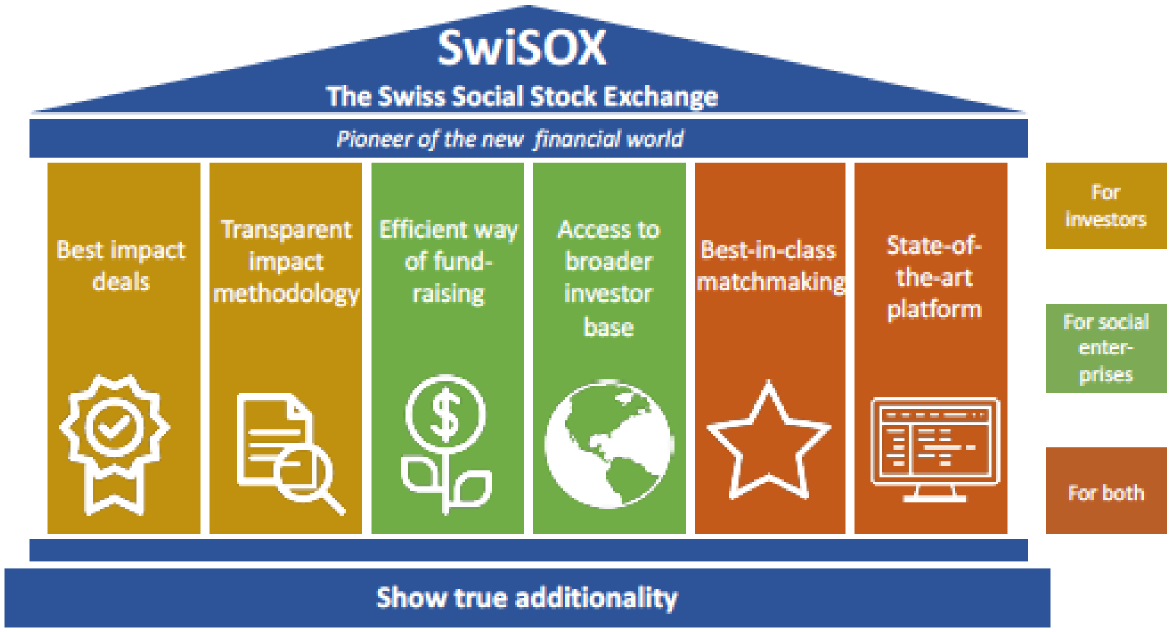
5.2 Stakeholders and product offering

In parallel, the study identifies banks, government, institutional investors, and wealth and asset managers as the key stakeholders to ensure the success and viability of the SWISOX. Most important are the financial institutions that can actively trade on the exchange for their account or on behalf of their clients, thereby providing much needed trading liquidity and an active secondary market for social enterprises' securities.

In contrast, surveying the current impact and social finance instruments and product offering, the study concludes that the main product offering of the SWISOX should focus on the security issuances of social enterprises and microfinance organizations, the shares of impact investment funds, and potentially social impact bonds (making a distinction with social bonds and green bonds that have been promoted by supranational organizations, the former, and extensively issued on traditional stock exchanges, the latter). The study concludes that these product offerings could significantly scale through a centralized platform that can also offer a secondary securities exchange market.

Matching impact investors with the potential product offering presents a significant opportunity for SWISOX to become a "one-stop shop" for all matters impact. Impact investors could trade equities, bonds, and funds; at the same time, investment funds could act on both sides by raising capital through an existing listing and exiting / purchasing underlying assets on the SWISOX.

5.3 Value proposition



The foundation of the value proposition of the SWISOX would be built on the promise to offer true additionality:

1- Bring new issuers (especially social enterprises) to the market that would otherwise not reach this stage of growth;
2- Bring new investors to the market that might otherwise not invest;
3- Connect the right investors (patient and committed) to the right companies (socially motivated);
4- Bring more capital into angel investing by extending the venture capital continuum into public listings, and offering an exit opportunity for early investors; and
5- Engage retail investors in impact investment.

6- Implementation

Two proposed implementation scenarios were evaluated: partnering with an existing stock exchange (or establishing one from scratch) and partnering with an existing platform (or establishing one from scratch). In both scenarios, it did not make economic sense to establish an exchange or platform from scratch given that such an undertaking would be faced with high initial and sunk costs and would be competing in an already crowded space of platforms and exchanges.

In both scenarios, several exchanges and platforms were evaluated according to their current offering, structure, sourcing, outreach, trading mechanisms, and finally their impact measurement frameworks. The study gleans on the main elements that should underpin any partnership.

When it comes to the legal and capital structure and ownership, both scenarios conclude that an ideal set-up for the SWISOX would be a separate legal entity based in Geneva and run as a limited company. This would especially ensure the representation of important stakeholders as shareholders and the adherence to the mission.

However, the big distinction between the scenarios is regarding the operating model and the potential to develop a robust revenue stream. Under the first option, partnering with an existing exchange, SWISOX could offer all the main services of a fully-fledged stock exchange: IPOs, secondary market trading, clearing and settlement services, as well as data services such as indices. On the other hand, a platform would be legally limited in its services and therefore the business model would be reduced to a simple transactional platform. Therefore, the study concludes that a partnership with an existing stock exchange is more likely to reach sustainability and ensure scale and viability.

Regarding the impact assessment methodology, SWISOX would need a comprehensive impact assessment tool that would combine a rating function and the ability to create and distribute regular impact reports to the relevant stakeholders. The tool should be cost efficient, transparent, and it should allow for cross-sectorial comparisons, which requires access to a broad impact database. The study concludes that SWISOX should, again, not go about creating a new tool, but rather select the most adequate from existing solutions.

7- Final recommendation

The study concludes that there is a strong business case for a social stock exchange, albeit with the right approach and the right stakeholders to ensure successful implementation. There are strong indications for demand for a centralized exchange platform from impact investors and social enterprises. Lessons learned from failed attempts show that only a fully-fledged stock exchange with a certain market-making ability and liquidity has the chance to become a relevant player in the impact investment world. Furthermore, engaging and ensuring the support of key stakeholders, early on in the set-up of SWISOX, is absolutely crucial. This should include investors, intermediaries such as global banks and market makers to bring liquidity and capital to the exchange, as well as government. In addition, a strong pipeline with committed issuers and investors has to be built-up, to show that such a stock exchange can really function and prove its additionality. The study strongly recommends that a solid pipeline of issuers should be in place before the launch of the exchange. The study further recommends that the SWISOX selects the most appropriate impact assessment tool, from existing tools and methodologies, to ensure consistency and transparency. Finally, the study recommends conducting additional research and explore different technologies for implementation purposes, such as blockchain.

Acknowledgements

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