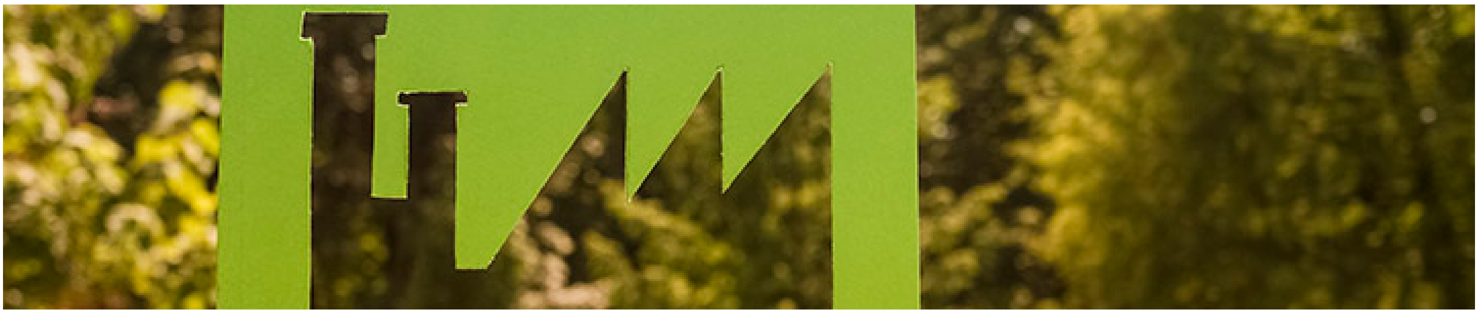
TOMORROW'S CHALLENGES



SUSTAINABLE INNOVATION (PART II)

SUSTAINABLE INNOVATION ISN'T JUST LIMITED TO PRODUCTS. FINANCIAL INSTITUTIONS CAN INNOVATE TOO

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While the previous article focuses on product-centric approaches, sustainable innovations do not necessarily need to be product-driven. As mentioned in the first article, the social needs that motivate actors into promoting sustainable innovations are those oriented with the social, economic, and environmental aspects of sustainability. The first two categories of social needs, namely social and economic, suggest that sustainable innovations can occur by empowering stakeholders through the creation of new value chains or the development of new business models and modes of thinking. While environmental crises, such as the one confronting the plastics sector explored in Part I, are more traditional problems to confront, the social and economic challenges are perhaps the most devastating to society.

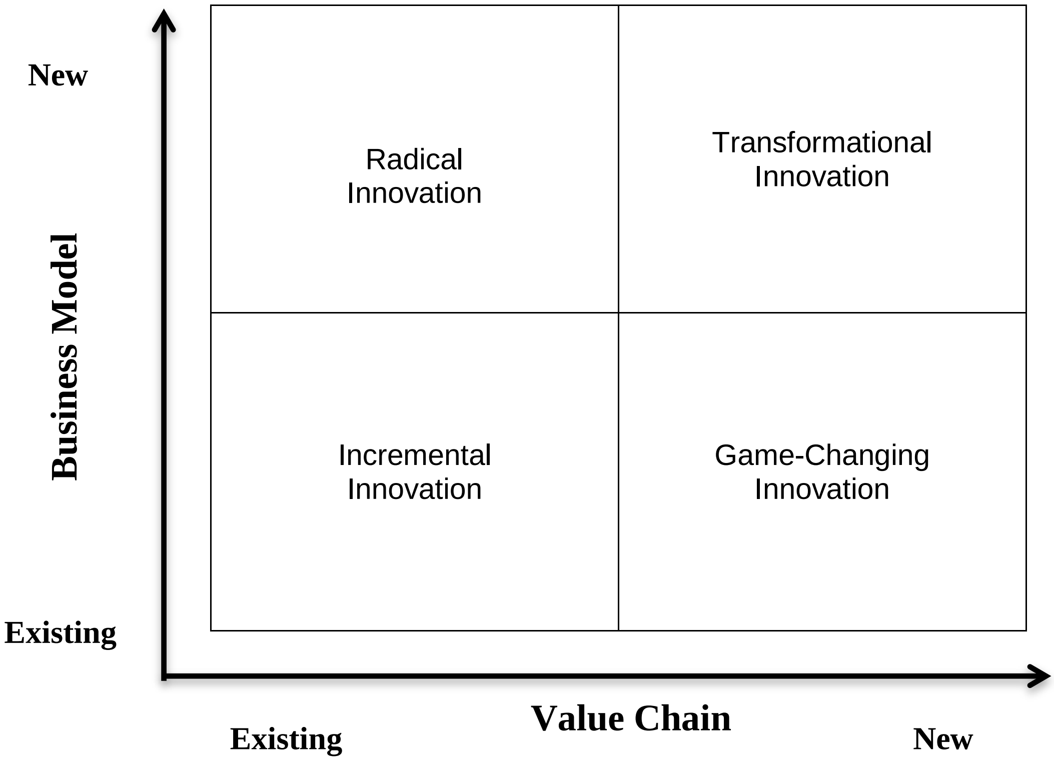

Figure 1: Rethinking Sustainable Innovation

Figure 1 presents a new way of differentiating between the four types of sustainable innovation we have identified. Instead of focusing on technology and markets, innovations can be categorized based on business models and value chains.

The long history of the sustainable finance movement helps us distinguish between the four stages of sustainable innovations. One of the first sustainable innovations in finance was a fair interest rate on loans. While this may seem obvious, at the time the upper classes in many civilizations prospered greatly from lower classes, which lacked access to alternative sources for capital, by charging exorbitant interest rates, or usury. Because this innovation did not create a new business model or value chain, it can be considered an incremental innovation.

An example of radical innovation is socially responsible investing (SRI), which emerged from various religious jurisprudences including Judaism and Islam but more formally began in the mid-1700s with the Quakers and Methodists. The rise of the slave-trade in the 1700s led Quakers and Methodists to develop the first negative-screening criteria in investments, refusing to invest in slave-trade enabled products and war-related activities.[1] The modern SRI movement has been traced to the political crises of the 1960s including the anti-Vietnam war protests and civil rights movement—particularly the race riots that ensued after the assassination of Martin Luther King, Jr.[2] This movement was further shaped and formalized in the late 1980s by an innovative financial response by churches, universities, and community groups to the Apartheid movement in South Africa.[3] We consider the SRI movement a radical innovation. Despite not significantly altering value chains, it represented a new way of thinking about money and consequently a change in current business models.

Although traditional lending is based largely upon a borrower's collateral in the case that the borrower defaults on a loan, microfinance enables the world's poorest—a population that was considered too "high risk"—to obtain financing otherwise. The formation of formalized microcredit institutions began in Europe during the 18th century to address economic crises afflicting lower social classes. For instance, the microcredit funds of Ireland emerged in the 1720s in response to extreme poverty and the lack of banking services to the poor who often needed loans to offset a bad harvest or illness.[4] Additionally, *Raiffeisenbanken* and *Volksbanken* in Germany originated as savings and credit cooperatives to serve the poor in rural and urban areas, respectively, after famines in 1846-1847.[5] Of course, many are already familiar with the modern-day microfinance boom, which has reached approximately 130 million of the world's poor. [6]

One of the most popular microfinance institutions is Grameen Bank, which was founded by Muhammad Yunus in 1977. In 1976, while serving as a professor at Chittagong University in Bangladesh, Yunus decided to loan 42 women in a neighboring village $27 each to help them create small business that could sustain them.[7] After its success, Yunus was able to secure a credit line to replicate his model on a larger scale, founding Grameen Bank in 1977. To help ensure repayment, borrowers accepted loans in groups of five people—thereby using social ties as collateral. As of 2010, Grameen Bank had approximately 1.7-billion USD in assets and by 2011, Grameen Bank had over 8-million borrowers across 97% of the villages in Bangladesh. Yunus and Grameen Bank received a Nobel prize in 2006 for their sustainable innovation.

We consider microfinance a game-changing innovation. While the business model is the same (banks loan money to lenders), the value chain has been completely altered by the inclusion of a new segment of the population. Triodos Bank's activities, on the other hand, would be examples of transformational innovation. Triodos Bank was founded in the 1970s as a sustainable bank that only invests in sustainable enterprises and makes its entire portfolio transparent and accessible to the public. By only using money for good, Triodos Bank is one of the first financial institutions that actually perceives financial gain as a means, not an end. Beyond developing negative criteria, Triodos Bank therefore has a set of positive criteria for investment—only companies that positively impact stakeholders can receive funding. Organic farms that aren't innovative enough or companies

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[1] Hutton, R. B., D'Antonio, L., & Johnsen, T. (1998). Socially Responsible Investing. *Business & Society, 37*(3), 281-305; Kinder, P., Lydenberg, S., & Domini, A. (1993). *Investing for good: Making money while being socially responsible*. New York: Harper Business; Schueth, S. (2003). Socially Responsible Investing in the United States. *Journal of Business Ethics, 43*(3), 189-194.

[2] Hutton, R. B., D'Antonio, L., & Johnsen, T. (1998). Socially Responsible Investing. *Business & Society, 37*(3), 281-305; Schueth, S. (2003). Socially Responsible Investing in the United States. *Journal of Business Ethics, 43*(3), 189-194.

[3] Guay, T., Doh, J., & Sinclair, G. (2004). Non-Governmental Organizations, Shareholder Activism, and Socially Responsible Investments: Ethical, Strategic, and Governance Implications. *Journal of Business Ethics, 52*(1), 125-139.

[4] Hollis, A., & Sweetman, A. (1998). Microcredit in Prefamine Ireland. *Explorations in Economic History, 35*(4), 347-380; Seibel, H. D. (2003). History matters in microfinance. *Small Enterprise Development, 14*(2), 10-12.

[5] Raiffeisen, F. W. (1866). *The Credit Unions* (7th ed.). Neuwied: Verlag der Raiffeisendruckerei; Seibel, H. D. (2003). History matters in microfinance. *Small Enterprise Development, 14*(2), 10-12.

[6] http://www.ifc.org/wps/wcm/connect/Industry_EXT_Content/IFC_External_Corporate_Site/Industries/Financial+Markets/MSME+Finance/Microfinance/

[7] Yunus, M., & Yusus, A. J. M. (1998). *Banker to the Poor*. Penguin Books India.

that are but don't address a social need are common examples of initiatives that Tirodos Bank refuses to fund. In addition to developing a new way of thinking about money, Triodos makes funding accessible to groups seeking microfinance and initiatives that otherwise wouldn't receive funding.

These impactful innovations therefore are not constrained to products but instead to the way money works and how it is distributed. In addition to product-centric processes, organizations can develop new business models and create alternative value chains to address a wider variety of societal needs.

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